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BEFORE THE ARIZONA CORPORATION COMMISSION

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ORIGINAL

IN THE MATTER OF THE APPLICATION OF  
EPCOR WATER ARIZONA INC., AN  
ARIZONA CORPORATION, FOR A  
DETERMINATION OF THE CURRENT FAIR  
VALUE OF ITS UTILITY PLANT AND  
PROPERTY AND FOR INCREASES IN ITS  
RATES AND CHARGES FOR UTILITY  
SERVICE BY ITS MOHAVE WATER  
DISTRICT, PARADISE VALLEY WATER  
DISTRICT, SUN CITY WATER DISTRICT,  
TUBAC WATER DISTRICT, AND MOHAVE  
WASTEWATER DISTRICT.

Docket No. WS-01303A-14-0010

Arizona Corporation Commission

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RUCO'S CLOSING BRIEF

(Redacted)

The RESIDENTIAL UTILITY CONSUMER OFFICE ("RUCO") hereby files its Closing Brief in the matter of EPCOR WATER ARIZONA, INC.'s ("EPCOR" or the "Company") application for a revenue increase totaling \$1,864,809 for its Mohave Water Division, \$554,266 for its Paradise Valley Water Division, \$1,125,509 for its Sun City Water Division, \$254,089 for its Tubac Water Division and \$443,696 for its Mohave Wastewater Division. Company Schedules A-1 Final<sup>1</sup>

<sup>1</sup> For ease of reference, all exhibits will be identified by exhibit number and all transcript references will be identified by page number in the transcript.

1                   **INTRODUCTION**

2

3           If anything else, this case has exposed significant and material depreciation issues.

4   RUCO has shown that the majority of the Company's revenue request in this case is based

5   on over-depreciated assets (\$5,489,050) and abnormal/debit accumulated depreciation

6   balances (\$5,906,243). R-1 and R-3. It is unfair that the Company's ratepayers should have

7   to pay more than once and in at least one instance over eight times for an asset. R-1

8   Account # 341100. Moreover, ratepayers should not have to pay for errors and unexplained

9   and unsupported accumulated depreciation debit balances which increase rate base and

10   have done so in some instances for over ten years and will continue to be in rate base at a

11   significant cost to the ratepayer unless and until the Commission does something about it.

12   This is not just one or two isolated instances, this is entry after entry establishing a clear

13   pattern of improper and/or inappropriate accounting.

14           Staff, recognizing this, sees the solution prospectively – address and fix the

15   depreciation accounting prospectively. The Company sees no errors (except the TF Main

16   Paradise Valley Account # 331001) and maintains that if there is doubt it should go in favor

17   of the past Commission decisions. Transcript at 220-221. RUCO's case on this issue was

18   compelling, and the Company's response was mostly unsupported denials and unsupported

19   guesses or in the case of the over-depreciated assets – it was what the Commission

20   previously approved so it must be right. The Company, not RUCO, has the burden of proving

21   and supporting its depreciation balances – balances by any accounting standard that are

22   abnormal and inappropriate. The ratepayer's deserve better. The ratepayer's should get a

23   credit for the excess depreciation that they have been forced to pay. Regardless of fault, it

24   is wrong, it has been wrong in the past, ratepayers have been paying for it and it is time it

1 stops. Ratepayers should also get some relief - nobody likes paying for the same thing more  
2 than once or to have to over-pay for something that was caused by somebody else's  
3 mistake. It is even more egregious to allow the situation to continue, unaddressed just  
4 because the Commission has approved it in the past. RUCO recommends the collection of  
5 excess depreciation stop and ratepayers be credited for the excess.

6 The Company's request for approximately \$12.2 million of post-test year plant is a  
7 big ask especially since the Company is requesting a \$28 million dollar SIB. Staff apparently  
8 has a new policy on this issue which allows for the inclusion of the "small" plant and  
9 associated costs now in post-test year plant which amounts cumulatively to approximately  
10 \$5.6 million dollars of the \$12.2 million requested in this case. Transcript at 821, 828-830.  
11 Staff's new criteria does not align with either of the two criteria that were the basis of Staff's  
12 policy in the last rate case<sup>2</sup>. Id., R-8. Staff's new policy also appears to not require a review  
13 by Staff's engineer of the \$5.6 million of plant in order to determine if it is used and useful –  
14 at least not prior to the hearing. Transcript at 821-822. Staff offers no explanation for the  
15 change in policy and if the Commission were to approve this portion of posttest year plant,  
16 it would be contrary to what Staff recommended and the Commission approved in the last  
17 rate case. R-8. It will also further what appears to be the on-going strategy employed by  
18 Companies to continue to ask for an accounting treatment previously denied, knowing that  
19 Staff will eventually flip its position and the Commission will likely approve it.

20 Finally, the Company's request for a \$28 million SIB for three of the five systems,  
21 while exorbitant, does not seem out of line given the Commission's generous policy on SIBs.  
22

23  
24 <sup>2</sup> In the last rate case Staff recognized two scenarios where post-test year plant is appropriate – the first  
involved the magnitude of the investment and the second required three criteria. RUCO-8 at 20. Neither the  
first criteria nor all of the 3 criteria in the second scenario are present in this case. Transcript at 828-832.

The Company's request will result in the following initial rate increase for a 5/8" x 3/4' residential ratepayer for the Sun City, Mohave and Paradise Valley Water Districts.

**MONTHLY RATE INCREASE FROM SIB MECHANISM**

| <u>DISTRICT</u>        |          | <u>Year 1</u> | <u>Year 2</u> | <u>Year 3</u> | <u>Year 4</u> | <u>Year 5</u> |
|------------------------|----------|---------------|---------------|---------------|---------------|---------------|
| <u>Sun City</u>        |          |               |               |               |               |               |
| Current Base Rates     | \$ 17.35 | \$ 17.35      | \$ 17.35      | \$ 17.35      | \$ 17.35      | \$ 17.35      |
| Requested Inc.         | \$ 3.38  |               |               |               |               |               |
| SIB Inc. over 5 years  | \$ 4.03  | \$ 4.66       | \$ 5.35       | \$ 5.93       | \$ 6.52       |               |
| Requested Inc. in Rate |          |               |               |               |               |               |
| Case Inc. SIB          | 19.48%   | 23.23%        | 26.86%        | 30.84%        | 34.16%        | 37.59%        |

|                        |          |          |          |          |          |          |
|------------------------|----------|----------|----------|----------|----------|----------|
| <u>Mohave</u>          |          |          |          |          |          |          |
| Current Base Rates     | \$ 20.63 | \$ 20.63 | \$ 20.63 | \$ 20.63 | \$ 20.63 | \$ 20.63 |
| Requested Inc.         | \$ 8.73  |          |          |          |          |          |
| SIB Inc. over 5 years  | \$ 9.62  | \$ 10.45 | \$ 11.30 | \$ 12.16 | \$ 13.00 |          |
| Requested Inc. in Rate |          |          |          |          |          |          |
| Case Inc. SIB          | 42.32%   | 46.61%   | 50.67%   | 54.77%   | 58.92%   | 62.99%   |

|                        |          |          |          |          |          |          |
|------------------------|----------|----------|----------|----------|----------|----------|
| <u>Paradise Valley</u> |          |          |          |          |          |          |
| Current Base Rates     | \$ 52.30 | \$ 52.30 | \$ 52.30 | \$ 52.30 | \$ 52.30 | \$ 52.30 |
| Requested Inc.         | \$ 3.03  |          |          |          |          |          |
| SIB Inc. over 5 years  | \$ 4.76  | \$ 6.41  | \$ 8.13  | \$ 9.84  | \$ 11.82 |          |
| Requested Inc. in Rate |          |          |          |          |          |          |
| Case Inc. SIB          | 5.79%    | 9.10%    | 12.25%   | 15.55%   | 18.81%   | 22.61%   |

R-19 at 6.

The SIB is far too inclusive, has too high of a cap, has completely gone beyond its original purpose, and is illegal.

This case is a train wreck and, at the very least, needs to be scaled back. The impact on ratepayers if approved will be great and that would be a tragedy under the circumstances of this case. RUCO urges the Commission to adopt its recommendations.

1 **RATEBASE**

3 **1) POST TEST-YEAR PLANT**

4 The Company is requesting approximately \$12.2 million in post-test year plant. Of  
5 that, approximately \$ 6.6 million is plant that is large in size (greater than \$250,000). R-26  
6 at 17. The remaining plant, approximately \$5.6 is smaller in size. Both RUCO and Staff  
7 recommend the inclusion of the bigger plant, but Staff has changed its historical approach  
8 on post-test year plant and is not recommending the inclusion of the smaller, ordinary plant  
9 totaling approximately \$5.6 million.

10 The issue of post-test year plant was addressed in the Company's last rate case for  
11 these systems. R-8, Docket No. SW-01303A-08-0227. In Decision No. 71410, the  
12 Commission adopted several of Staff's adjustments to remove proposed post-test year plant  
13 additions from the rate setting process. R-26 at 10. Staff explained in the Company's last  
14 rate case that the matching principle is the reason that the Commission has allowed  
15 inclusion of post-test year plant in rate base only in special and unusual situations, which  
16 could be summarized as follow:

17 1) when the magnitude of the investment relative to the utility's total investment  
18 is such that not including the post-test year plant in the cost of service would jeopardize the  
19 utility's financial health;

20 2) the cost of the post-test year plant is significant and substantial;

21 3) the net impact on revenue and expenses for the post test year plant is known  
22 and insignificant (or is revenue-neutral); and

23 4) the post-test year plant is prudent and necessary for the provision of services  
24 and reflects appropriate, efficient, effective, and timely decision-making.

1 Id. at 10-11, R-8 at 19-20.

2 Staff's reasoning in the Company's last rate case is still sound. Regardless of whether  
3 the regulatory agency uses an historic test year or fully forecast rate year the matching principal  
4 is what controls. R-26 at 11. Only by matching costs and revenues will the test period be the  
5 proper basis for setting rates that are just and reasonable. For example, the inclusion of  
6 costs without matching revenues may produce excessive rates. Similarly, the inclusion of  
7 revenues without matching costs may deny the utility reasonable rates. Id.

8 The Company's request to include the smaller post-test year plant, and Staff's support  
9 should be denied. First, the plant in question is simply routine capital improvements which  
10 are comprised of installing short sections of mains, small pumps, miscellaneous tools and  
11 equipment and other items considered general equipment. A-15 at page 12. This also includes  
12 replacement of hydrants, valves, meters services and vehicles A-15 at page 14.

13 Second, the proposed projects each fail one or more of the Commission's guiding  
14 principles for inclusion as post-test year plant. R-26 at 18. A review of the Company's  
15 proposed projects show that there are over 65 different individual project or blanket work orders  
16 and none of them are of such a dollar magnitude that exclusion would jeopardize the  
17 Company's financial health or that they are of a magnitude that they are a significant  
18 investment. Id. Any project involving planned replacement of meters, services or valves are  
19 not revenue neutral as they are being done to decrease lost and unaccounted for water which  
20 acts to both decrease water pumping and water treatment expenses and at the same time  
21 increase billed revenues to the Company. Id. This is a clear violation of the matching principal  
22 of revenues and expenses. The inclusion of routine projects while certainly used and useful  
23 again fail the test of the matching principal and dollar significance, there is also no showing that  
24 they are vitally necessary to continued provision of service. For example, what is so vital as a

1 "miscellaneous tool" or the replacement of one vehicle or map? Of course, equipment will wear  
2 out and need to be replaced but there is no explanation of why its' "necessary for the provision  
3 of services and reflects appropriate, efficient, effective, and timely decision-making."  
4 Because of all these failures of showing that, these projects are special and/or unusual they  
5 should not be included in post-test year plant. Id.

6 At the hearing, Staff's witness, Mary Rimback, testified that that no engineer had gone  
7 out, at least until that point, to look at the smaller plant. Transcript at 822. Ms. Rimback  
8 further testified that Staff had not made a determination if this plant was used and useful, at  
9 least from an engineering perspective. Transcript at 822. Apparently, Staff does not make  
10 such engineering determinations on small plant – only on larger plant. Id. at 823 Ms. Rimback  
11 further admitted that the plant in question was not unusual and was routine. Transcript at 826.  
12 When questioned on Staff and the Commission's criteria addressed in Decision No. 71410,  
13 Ms. Rimback was unable to explain how Staff's recommendation met all of the criteria Staff set  
14 forth in the last case. Id. at 828-830. Staff's reasoning for including the small plant, as Ms.  
15 Rimback explains is "We are including it as necessary for the efficiency of the water company  
16 and the wastewater company." Id. at 829. In essence, Staff is now opening up post-test  
17 year plant to just about anything without an explanation why the Commission should change  
18 its policy.

19 RUCO recommends that the Commission remain consistent for good reason and  
20 exclude smaller plant from its post test-year plant determination.

1                   **2) ACCUMULATED DEFERRED INCOME TAX ("ADIT")**

2                   It is axiomatic that in ratemaking, a utility earns a return on its rate base for investments  
3                   financed by investors that are used and useful. Transcript at 771. ADIT represents a significant  
4                   source of non-investor supplied capital from the utility's collection of deferred income tax expense  
5                   from ratepayers. Id. ADIT is typically reflected as a deduction to rate base, which is a reflection  
6                   of the fact that the source of the funding is non-investor supplied cost-free capital. R-24 at 38.  
7                   Some components of deferred income tax expense and ADIT, such as tax depreciation, are  
8                   directly related to plant. Consequently, the impacts of tax depreciation on ADIT should be  
9                   appropriately coordinated in determining the utility's rate base. Transcript at 771.

10                  There is also a serious mismatching issue with EPCOR's proposed ADIT amount.  
11                  EPCOR has proposed a test year ending June 30, 2013. Transcript at 787. EPCOR has also  
12                  included post-test year plant. However, EPCOR did not adjust its ADIT balance from December  
13                  31, 2012 through June 30, 2013, as documented on RUCO witness Smith's Attachment RCS-4,  
14                  pages 71-72 of 76. R-24. Failure to update ADIT balances to the end of the test year reflects  
15                  the poor accounting practices at EPCOR, which have become evident in other areas of this case  
16                  as well, including plant and accumulated depreciation accounting. To properly match test year  
17                  plant in rate base with the ADIT, the ADIT balance needs to be revised. Transcript at 771-772.  
18                  RUCO's witness Ralph Smith demonstrated clear, up-to-date knowledge of the tax normalization  
19                  guidance related to ADIT, and has recommended the minimum necessary adjustment that  
20                  should be made in the current case. Tr. at 771-773.

21                  The tax depreciation claimed on the Company's tax return results in increases to ADIT  
22                  and that has produced tax savings, should be coordinated with the amount of plant that is  
23                  reflected in the utility rate base. Id. In 2013, regular MACRS tax depreciation and 50 percent  
24



1 bonus tax depreciation became available and was utilized by the Company. Id. RUCO verified  
2 this through data requests which resulted in, among other things, a copy of the Company's 2013  
3 US federal income tax return. Id. Coordinating or matching the net impact of the 2013 tax  
4 depreciation on ADIT is appropriate to ascertain the effect on the Company's rate base. Id.  
5 RUCO's witness, Ralph Smith testified that the ADIT amounts should be increased by  
6 approximately \$3 million in total to reflect the net impact of 2013 tax depreciation and ADIT  
7 balances that are updated to December 31st, 2013. Id. R-25, Attachment RCS-8 Schedule B-1,  
8 RUCO allocated the ADIT amounts to the districts using a customer factor. Transcript at  
9 772. The ADIT amounts for each of the five districts in the current rate case should be increased  
10 by sum to \$872,727 for the five districts combined. The adjustment to ADIT for the net impact  
11 of 2013 tax depreciation reduces the company's proposed rate base by \$872,727 for the five  
12 districts combined. R-25, Attachment RCS-8 Schedule B-1.

### 14 **3) DEPRECIATION**

15 Two of the largest rate base issues in dispute concerns the balances of accumulated  
16 depreciation ("A/D") associated with numerous specific utility plant in service ("UPIS") accounts.  
17 The first issue concerns a number of accounts that are over-depreciated and had excessive  
18 credit balances at Test Year ("TY") end – June 30, 2013. In fact, upon closer examination, the  
19 majority of the over-depreciated UPIS accounts were over-depreciated at the time of each  
20 district's previous rate cases. The second rate base issue is the numerous abnormal debit  
21 balances associated with UPIS accounts in each of the districts.

22 There were 24-combined UPIS accounts within the five districts filed in this case, including  
23 the allocable Arizona Corporate plant accounts, which were over-depreciated or had excessive  
24 credit balances beyond the UPIS balance itself, which indicates over-depreciated assets. R-1 at

1 1. Fundamental ratemaking allows a utility a return "on" and "of" its investor supplied capital  
2 investments. However, fundamental ratemaking does not allow a utility multiple recoveries of its  
3 investments. From simply a fairness perspective, it is counter-intuitive that a ratepayer should  
4 pay more than once for plant. Neither the Internal Revenue Service ("IRS") for income tax  
5 purposes nor Generally Accepted Accounting Principles ("GAAP") allow for over-depreciation of  
6 assets. Transcript at 501. In fact, the Company recognized this improper ratemaking issue and  
7 proposed to cease its further request for additional depreciation expense on a going forward  
8 basis by adopting Staff's proposal in its rebuttal testimony A-8 at 31. RUCO's regulatory liability,  
9 which credits future depreciation expense going forward, corrects for this oversight from previous  
10 rate cases.

11 The extent and the degree of the over-depreciation in this case is far too great to simply  
12 ignore. Likewise, the Company's explanations in this area as well as the abnormal debit  
13 accumulated depreciation balances in UPIS accounts are for the most part inconsistent,  
14 unsupported or simply incredulous.

15 At TY end, certain groups of asset accounts were over-depreciated by **\$5,489,050<sup>3</sup>** as  
16 shown in Table 1 below:

17  
18 Table 1  
19 Over-Depreciated Plant Balances

| <u>District</u> | <u>UPIS<br/>Balance</u> | <u>TY End<br/>A/D<br/>Balance</u> | <b><u>Over-Depre.<br/>Thru<br/>TY End<sup>4</sup></u></b> | <u>Over-Depre.<br/>Thru<br/>6/30/2015</u> |
|-----------------|-------------------------|-----------------------------------|---|---|
| Mohave Water    | \$377,237               | \$1,133,395                       | <b>\$756,159</b>  | \$ 823,406                                |

23  
24 <sup>3</sup> R-3.

<sup>4</sup> Ibid.

Table 1 (continued)

| <u>District</u>                         | <u>UPIS<br/>Balance</u> | <u>TY End<br/>A/D<br/>Balance</u> | <u>Over-Depre.<br/>Thru<br/>TY End<sup>5</sup></u> | <u>Over-Depre.<br/>Thru<br/>6/30/2015</u> |
|---|-------------------------|-----------------------------------|--|---|
| Paradise Valley                         | \$690,784               | \$1,740,784                       | <b>\$1,050,000<sup>6</sup></b>                     | \$1,173,449                               |
| Sun City                                | 1,194,876               | 3,922,824                         | <b>2,727,948<sup>7</sup></b>                       | 3,196,775                                 |
| Tubac                                   | 18,502                  | 64,682                            | <b>46,180<sup>8</sup></b>                          | 53,314                                    |
| Mohave WW <sup>9</sup>                  | N/A                     | N/A                               | <b>N/A</b>   | N/A                                       |
| AZ-Corporate <sup>10</sup><br>4,219,633 | 2,110,462               | 5,321,528                         | <b><u>3,211,066<sup>11</sup></u></b>               |   |
| Total.....                              |                         |                                   | <b>\$ 5,489,050<sup>12</sup></b>                   |   |

The Company will collect through June 30, 2015 approximately \$6.5M from ratepayers in over-depreciation in these five districts including the Arizona Corporate allocable accounts R-14 at Schedule 4, R-15 at Schedule 4 and RUCO Final Schedules at Schedule TJC-4. One account for example, involves the Transportation Equipment in the Mohave Water District – Account No. 341100. The plant balance was \$99,015 and the Company has recorded \$808,721 of accumulated depreciation. R-1 at 1. The delta, \$709,706 represents excessive credit balances over the UPIS balances, which represents the amount of over-depreciation that ratepayers have

<sup>5</sup> Ibid.

<sup>6</sup> Not adjusted to account for PV adjustments / transfers accounting errors treated as retirements.

<sup>7</sup> One-dollar difference due to rounding.

<sup>8</sup> R-3.

<sup>9</sup> Mohave Wastewater District did not have any UPIS accounts over-depreciated other than allocable over-depreciated AZ-Corporate plant. This district had only abnormal debit accumulated depreciation balances largely due to self / under-insurance for flood damaged property written-off early in the assets lives.

<sup>10</sup> The amounts listed on this line are allocated based on each districts rate base allocation factors. The five districts in this case have over-paid depreciation expense through TY end of \$908,762. R-3

<sup>11</sup> Of the \$3,211,066 above, \$908,762 is allocable to the five-districts in this case. R-3

<sup>12</sup> One-dollar difference is due to rounding factors. R-3

1 paid for this plant. Stated another way, ratepayers will have paid for this plant eight times over.  
2 This is simply unacceptable and must be stopped.

3 Another account concerns Transportation equipment in the Sun City District – Account  
4 No. 341100. R-1. Here, the Company's plant in service shows a balance of \$976,241. The  
5 Company's accumulated depreciation balance is \$3,021,077. Id. The delta, \$2,044,836  
6 represents the amount EPCOR's customers have overpaid on this one account in depreciation  
7 expense. In total the amount of the over-depreciation for the five districts at TY end is  
8 \$5,489,050. R-1. The Company really offers no persuasive argument for supporting any of this  
9 other than this is the result of what the Commission ordered in the past. The Company now  
10 recognizes this fact in its rebuttal testimony and ceased its request for further over-depreciation.  
11 A-8 at 31. In other words, if the Commission made a mistake there is nothing that should be done  
12 about it other than stopping the inappropriate accounting here in this case. This is troubling and  
13 RUCO is very troubled by the fact that neither the Company nor the Staff see the need to correct  
14 this imbalance and credit something back to the ratepayers. Again, this case screams for change  
15 and ratepayer relief.

16 On cross examination there were a series of questions relating to whether depreciation  
17 reserve adjustments that have been applied to water companies. Transcript at 909-911. This  
18 issue is a red herring meant to deflect the real issue. Depreciation expense and depreciation  
19 reserves are the means by which a company, any company, is compensated for the original cost  
20 it invested in an asset. Transcript at 910-911. The depreciation expense is the annual expense  
21 for cost of the asset over the ratable life of that asset. Transcript at 909-911. The depreciation  
22 reserve is a running total of all depreciation related expenses and recoveries (retirements, cost  
23 of removal, salvage, etc.). Transcript at 909-911. A comparison of the actual depreciation  
24 reserve and the calculated depreciation reserve is a reserve study which shows how well the

1 depreciation rates are collecting the necessary amounts to compensate the utility for the  
2 investment it made. Transcript at 909-911. Water companies like electric company's or any other  
3 company's do not have special rules that exempt them from this. Each Company should only  
4 be allowed to collect its original investment, not two times or three times or even more as the  
5 Company recommends in this case. This not only violates basic regulatory accounting it violates  
6 the Commission's Rules. A.A.C. R-14-2-102(A)(3). R-2. RUCO's analysis here shows that there  
7 is excess reserve which is due in part to bad accounting or an over recovery of assets that are  
8 no longer in service. These are simple facts of errors and prior analyst oversight, and they  
9 should be corrected as RUCO proposes.

10 Interestingly, EPCOR agrees that the Company should stop depreciating primary plant  
11 accounts once the entire account is fully depreciated on a prospective basis. A-13 at 6.  
12 EPCOR's recommendation really says - let me keep the money now but I won't do it again.  
13 EPCOR's recommendation does nothing to correct the past over collections for ratepayers.

14 Perhaps equally as troubling is the second issue previously mentioned with accumulated  
15 depreciation balances that have abnormal/debit accumulated depreciation balances the  
16 Company is recommending in this case. It is abnormal to have numerous debit accumulated  
17 depreciation balances. Why for example, should there ever be an accumulated depreciation  
18 debit balance on an account where the depreciation rate is zero? How is this even possible that  
19 there is accumulated depreciation on plant that has a zero depreciation rate? In this case, there  
20 is close to 40 debit accumulated depreciation balances, which are essentially assets in the  
21 accumulated depreciation balances that increase ratebase and will continue to do so if approved.  
22 And according to the Company only one of those was the result of an error. Transcript at 111.  
23 The abnormal debit depreciation balances are a sure sign of a long history of improper and/or  
24 erroneous accounting errors or at the very least poor bookkeeping which should not come at the

1 expense of the rate payer and surely should not be allowed to continue. Given the difficulty that  
2 Staff and RUCO had with just getting the opening balances in this case, it is not a stretch to see  
3 how there could be so many abnormal depreciation balances when asset transfers were clearly  
4 treated wrongly and mis-accounted for as retirements as in the Paradise Valley District. R-14.

5 In responses to numerous Staff and RUCO data requests, the Company provides several  
6 reasons for these abnormal debit accumulated depreciation balances. First, EPCOR states that  
7 the abnormal debit balances were caused by early retirements. A-13 at 3. EPCOR further  
8 explains that the retirement of an asset earlier than its average service life is a common  
9 occurrence for groups of assets which in turn creates an undepreciated balance for that asset.  
10 Id. at 4. While the Company's explanation point to one possible explanation, - the facts of this  
11 case show otherwise. First, the utility presents little if any facts that the abnormal debit  
12 accumulated depreciation balances were caused by early retirements. Since the utility is the  
13 entity that keeps the accounting data for plant in service and retirements, if the abnormal  
14 depreciation balances were caused by early retirements it should be able to show that quite  
15 easily. EPCOR chooses to overlook abnormal depreciation balances from accounts that have  
16 no depreciation rates which comes at a high expense to the ratepayer. For instance, there was  
17 a lot of testimony on the "organization" account in the Paradise Valley District. The debit  
18 accumulated depreciation balance in this account was (\$477,283). This debit balance is on an  
19 account that has a zero depreciation rate. R-3. Ultimately, the Company's witness on this,  
20 Sheryl Hubbard explained this debit balance arose from differences between the general ledger  
21 and fixed asset accounting systems' accumulated depreciation balances. Transcript at 109, 152,  
22 1132, and 1142. This \$477,283 debit balance, which increases ratebase and hence rates, has  
23 been sitting dormant on the Company's books since December 2004 earning a rate of return,  
24 absent removal, into perpetuity with a zero percent depreciation rate. Transcript at 109, 152,

1 1132, and 1142. Now is the time to clean up these debit balances which have no value to the  
2 ratepayer – only cost. The Organization costs of the Company's predecessor, AZ-AM or  
3 Citizens, have no value to the current EPCOR rate payers, In fact, RUCO calculated the extra  
4 cost of this abnormal debit accumulated balance to the ratepayer over a 10 year period at  
5 \$590,288. R-3.

6 That is not to say that there were not retirements. RUCO did identify some legitimate  
7 early retirements in the Mohave Wastewater District. However, the majority of those outstanding  
8 debit accumulated depreciation balances were a result of flood damage that EPCOR's  
9 predecessor Arizona-American chose to self-insure against with a high deductible, which the  
10 ratepayers should be held harmless for. Transcript at 133. RUCO recommends that each of the  
11 abnormal debit balances be reset to zero.

12 Second, the Company argues that the abnormal debit balances were approved in the  
13 districts' last rate cases. For e.g. – see R-3 last page. This, however, presupposes that those  
14 debit balances were in fact correct in those cases. In fact, RUCO proved that approximately half  
15 of the debit balances were created through faulty accounting of asset adjustments / transfers  
16 that were improperly accounted for as retirements in the Paradise Valley Water District, which  
17 RUCO proved and corrected during the hearing in this matter. R-14 and RUCO Final Schedules  
18 at Schedule TJC-4. The third and less used explanation that the Company claims caused the  
19 debit balances were in response to RUCO DR's 13.2 and 13.3:

20 Excerpts of Responses Provided to RUCO DR 13.2 and 13.3:

21 We are unable to locate the original support for the rationale of this debit  
22 balance.

1 R-3 – last page. From what RUCO can determine through the course of this proceeding and its  
2 investigation into this matter, this third argument explains the majority of the abnormal debit  
3 accumulated depreciation balances.

4 In total the abnormal debit accumulated depreciation balances amount to \$5,906,243. R-  
5 3. However, through the hearing it was agreed that three accounts were in error, the TD Mains  
6 in the Paradise Valley system. R-17. These accounts amount to (\$2,981,428). R-3. The total  
7 of the abnormal debit balance accounts is (\$3,170,346) which is still a very significant number.  
8 The evidence indicates that the abnormal accumulated depreciation balances are not due to  
9 early retirements but rather bad accounting. See for example R-17.

10 Based on the detailed review of the accounting entries that RUCO and Staff performed,  
11 RUCO has proposed a series of adjustments to correct for them. The existence of the over  
12 recovery shows the need for a full depreciation study for all accounts. RUCO recommends that  
13 the utility be directed to perform a depreciation study and reflect the results of that study in its  
14 next rate case filing.

15 There has not been a depreciation study for a number of years that analysis was only was  
16 of a comparative analysis of one utility's rates versus others. A-13 at 8. Depreciation studies are  
17 also useful in assessing if the current rates are reasonable and if they should change over time.  
18 Another reason for a depreciation study is that any over or under recoveries of depreciation  
19 reserves can be identified. Transcript at page 909-911. This examination of how much should  
20 be in the reserve versus how much is in the reserve is known as a reserve study. If existing  
21 service lives are too short, there will be an excess in reserves as the plant did not retire as  
22 assumed and too much depreciation expense was accumulated. Id. The reverse is true if existing  
23 service lives are too short. Id. If only small over or under recoveries are found, changes to the  
24 rates may adequately address the issue. Id. If large changes are found amortizations (positive



or negative) may be used so that neither the utility nor the customer is unduly burdened with incorrect rates. Id. Both of these methods of true up are common in the industry and this should have been done when the last study was done<sup>13</sup>.

RUCO's other rate base adjustments all involve non-traditional ratemaking requests for other issues in this case. In summary, RUCO is proposing the following rate base adjustments:

TABLE 2  
RUCO Rate Base Adjustments Reflected in Final Schedules

| Description                 | Mohave Water         | Paradise Valley      | Sun City Water       | Tubac Water         | Mohave Wastewater   |
|-----------------------------|----------------------|----------------------|----------------------|---------------------|---------------------|
| <b>Company RB As Filed</b>  | <b>\$ 23,496,514</b> | <b>\$ 39,380,442</b> | <b>\$ 26,409,286</b> | <b>\$ 1,607,775</b> | <b>\$ 5,305,082</b> |
| <b>RUCO RB Adjustments:</b> |                      |                      |                      |                     |                     |
| RB Adj. #1<br>Direct Plant  | \$ -                 | \$ 1,102             | \$ 247,990           | (\$249,315)         | \$ -                |
| RB Adj. #2<br>Direct A/D    | 545,562              | (241,319)            | 2,038,336            | 276,778             | (413,165)           |
| RB Adj. #3<br>AZ Corp Plant | -                    | -                    | -                    | -                   | -                   |
| RB Adj. #4<br>AZ Corp A/D   | 376,174              | 3,791                | 18,075               | 469                 | 1,109               |
| RB Adj. #5<br>PTY Plant     | (6,026,224)          | (1,601,236)          | (2,128,789)          | (21,365)            | (99,345)            |

<sup>13</sup> Nevada PUC Docket No. 13-06004 – Application of Sierra Pacific Power Company d/b/a NV Energy for approval of new and revised depreciation rates for its electric and common accounts, Order issued December 16, 2013, paragraphs 178-184. Docket No. 090130-EI – Order denying in Part and granting in Part Florida Power & Light Company's Request for a Permanent Rate Increase and Setting Depreciation and Dismantlement Rates and Schedules, Order No. PSC-10-0153-FOF-EI, issued March 17, 2010, page 87. Docket No. 09-12-05 - Application of the Connecticut Light & Power Company to Amend its Rate Schedules, Order Issued June 30, 2010, page 76.

|    |                       |                      |                      |                      |                     |                     |
|----|-----------------------|----------------------|----------------------|----------------------|---------------------|---------------------|
| 1  |                       |                      |                      |                      |                     |                     |
| 2  | RB Adj. #6            |                      |                      |                      |                     |                     |
| 3  | Direct Over-Depre.    | (658,725)            | (930,034)            | (2,218,405)          | (42,651)            | -                   |
| 4  |                       |                      |                      |                      |                     |                     |
| 5  | RB Adj. #7            |                      |                      |                      |                     |                     |
| 6  | Corp Over-Depre.      | (353,366)            | (107,883)            | (514,314)            | (13,338)            | (31,559)            |
| 7  |                       |                      |                      |                      |                     |                     |
| 8  | RB Adj. #8            |                      |                      |                      |                     |                     |
| 9  | Unexpended CIAC       | (69,169)             | (43,632)             | (845,933)            | (74,010)            | (227,674)           |
| 10 |                       |                      |                      |                      |                     |                     |
| 11 | RB Adj. #9            |                      |                      |                      |                     |                     |
| 12 | 24-Mths AFUDC         | (806,861)            | (427,597)            | (225,112)            | (27,978)            | (28,717)            |
| 13 |                       |                      |                      |                      |                     |                     |
| 14 | RB Adj. #10           |                      |                      |                      |                     |                     |
| 15 | Working Capital       | (14,904)             | (34,254)             | (36,197)             | (5,951)             | (10,903)            |
| 16 |                       |                      |                      |                      |                     |                     |
| 17 | RB Adj. #11           |                      |                      |                      |                     |                     |
| 18 | Reg. Assets           | (67,042)             | (351,088)            | -                    | (55,412)            | -                   |
| 19 |                       |                      |                      |                      |                     |                     |
| 20 | RB Adj. #12           |                      |                      |                      |                     |                     |
| 21 | Surrebuttal           | (195,755)            | (92,263)             | (349,527)            | (11,409)            | (26,995)            |
| 22 |                       |                      |                      |                      |                     |                     |
| 23 | Rounding Adjustment   | -                    | (1)                  | 1                    | -                   | 1                   |
| 24 |                       |                      |                      |                      |                     |                     |
|    | <b>RUCO</b>           |                      |                      |                      |                     |                     |
|    | <b>RB As Adjusted</b> | <b>\$ 16,226,204</b> | <b>\$ 35,556,028</b> | <b>\$ 22,395,411</b> | <b>\$ 1,383,593</b> | <b>\$ 4,467,834</b> |

RUCO Rate Base Adjustment #1 in Table 2 reflects removal of negative direct UPIS balances and the associated accumulated depreciation balances for specific accounts. There simply isn't a rationale for a negative plant balance outside of an accounting error being made to create a negative UPIS balance. RUCO Final Schedule 4 at Adjustment #1 for Tubac. For the Paradise Valley District, this adjustment also encompasses the removal of the double-count for the fire mains account of \$14,058, which is already accounted for in the supply mains account. For the Tubac Water District, this adjustment relates to

1 reclassifying the arsenic treatment plant from a non-media account to a media account and  
2 disallows the amount that Staff removed and adopted in Decision No. 71867 dated  
3 September 1, 2010 (Tubac's ACRM filing). These adjustments are shown in detail in  
4 RUCO's Final Schedules on Schedule 5.

5  
6 RUCO Rate Base Adjustment #2 in Table 2 reflects the adjustments to direct plant to 1)  
7 remove the excess over-depreciation necessary to setup the regulatory liability<sup>14</sup> to amortize  
8 the credit to the depreciation expense on a going forward basis and 2) to remove the  
9 abnormal debit accumulated depreciation balances discussed at length during the hearing.  
10 R-1, R-3, and RUCO Final Schedules 6. These adjustments are shown in detail in RUCO's  
11 Final Schedules on Schedule 6.

12  
13 RUCO Rate Base Adjustment #3 in Table 2 is intended for any adjustments to Arizona  
14 Corporate UPIS. RUCO did not recommend any adjustments to the AZ-Corporate UPIS.  
15 Therefore, this adjustment is intentionally left blank. This s reflected in RUCO's Final  
16 Schedules on Schedule -7.

17  
18 RUCO Rate Base Adjustment #4 in Table 2 reflects the adjustments to remove the excess  
19 over-depreciation of the AZ-Corporate allocable plant necessary to setup the regulatory  
20 liability<sup>15</sup> to amortize the credit over a 5-year period to the depreciation expense on a going  
21 forward basis and 2) to remove the allocable abnormal debit accumulated depreciation

22  
23  
24 <sup>14</sup> The direct plant regulatory liability is shown on RUCO Final Schedule 10 while the AZ Corporate plant  
regulatory liability is reflected on RUCO Final Schedule 11.

<sup>15</sup> Ibid.

1 balances discussed at length during the hearing. RUCO Final Schedules 8 These  
2 adjustments are shown in detail in RUCO's Final Schedules on Schedule 8.

3  
4 RUCO Rate Base Adjustment #5 in Table 2 reflects the adjustments to remove the post- test  
5 year plant disallowed by Mr. Frank Radigan using the criteria established by Staff in  
6 numerous prior rate cases. RUCO Final Schedules 4 These adjustments are shown in detail  
7 in RUCO's Final Schedules on Schedule 9.

8  
9 RUCO Rate Base Adjustment #6 in Table 2 reflects the adjustments that establishes the  
10 direct plant regulatory liability necessary for the over-depreciation to amortize the credit to  
11 the depreciation expense on a going forward basis to make ratepayers whole again. RUCO  
12 Final Schedules 4 These adjustments are shown in detail in RUCO's Final Schedules on  
13 Schedule 10.

14  
15 RUCO Rate Base Adjustment #7 in Table 2 reflects the adjustments that establishes the  
16 Arizona Corporate plant regulatory liability necessary for the over-depreciation to amortize  
17 the credit to the depreciation expense on a going forward basis to make ratepayers whole  
18 again. RUCO Final Schedules 4 These adjustments are shown in detail in RUCO's Final  
19 Schedules on Schedule 11.

20  
21 RUCO Rate Base Adjustment #8 in Table 2 reflects the adjustments to reverse the  
22 Company's non-investor supplied capital (i.e., cash) adjustment for contributions in aid of  
23 construction ("CIAC"). The most basic and elementary rule of ratemaking clearly establishes  
24 that any non-investor supplied source of capital is a reduction to rate base. This adjustment

1 recognizes that fact and treats the source of funds accordingly. The Company fails to  
2 establish a separate interest bearing account for the unexpended CIAC funds, which allows  
3 the Company to deposit the non-investor supplied funds in its general account to be  
4 expended on any item (i.e., wages, purchased power, and/or chemicals etc.) without having  
5 to use their own investor funds when paying any period and/or capital expenditures. Any  
6 and all non-investor supplied capital is a reduction to rate base. These adjustments are  
7 shown in detail in RUCO's Final Schedules on Schedule 12.

8  
9 RUCO Rate Base Adjustment #9 in Table 2 is another request by the Company that should  
10 be rejected by the Commission as being seriously flawed. These adjustments reflect the  
11 reversal of the Company's request for an additional 24-months for allowance of funds used  
12 during construction ("AFUDC"). This Company adjustment was denied in the Chaparral  
13 case and should be rejected here too. It is not sound ratemaking or public policy to do  
14 otherwise. These adjustments are shown in detail in RUCO's Final Schedules on Schedule  
15 13.

16  
17 RUCO Rate Base Adjustment #10 in Table 2 reflects the cash working capital lead/lag  
18 adjustments necessary to 1) recognize RUCO's levels of operating expenses in the lead/lag  
19 study for cash working capital; 2) disallow the inclusion of bad debt expense as a non-cash  
20 item plus the Company's methodology of computing its revenue lead/lag days (i.e., similar  
21 to accounts receivable turnover calculation) has already accounted for the bad debt  
22 expense, which is further supported by RUCO's Direct Testimony Attachment #4, which is  
23 an excerpt from the publication titled Accounting for Public Utilities authored by Hahne and  
24 Aliff on pages 5-7 through 5-9; and 3) recognizing the industry standard of 91.25 days for

1 interest expense lag days. R-14. These adjustments are shown in detail in RUCO's Final  
2 Schedules on Schedule 14.

3  
4 RUCO Rate Base Adjustment #11 in Table 2 reflects the Company's admittance to  
5 improperly including certain regulatory assets in the calculation of revenue requirements.  
6 These adjustments are shown in detail in RUCO's Final Schedules on Schedule 15.

7  
8 RUCO Rate Base Adjustment #12 in Table 2 reflects three different adjustments made to  
9 properly account for 1) eliminating the regulatory liability established by the Company for the  
10 low-income over-collections for Mohave and Sun City Water Districts and recording the over-  
11 collections as revenue; 2) accumulated deferred income taxes ("ADIT"); and 3) Tubac's  
12 ACRM accounting as discussed in Mr. Michlik's testimonies. These adjustments are shown  
13 in detail in RUCO's Final Schedules on Schedule 16.

14 **OPERATING EXPENSES**

15  
16 There are many disputed issues in this case - perhaps because many of the  
17 Company's requests involve non-traditional ratemaking as well as the application of new  
18 and clever ways to treat the issues. For the most part, these proposals shift the risk to the  
19 ratepayer. The Company overlooks this detail, and in fact still maintains its risk is greater  
20 than what either Staff or RUCO recommend (See Cost of Capital section). Nonetheless, the  
21 Commission should continue to authorize only proven and traditional ways of ratemaking.

22 In summary, RUCO is proposing the following operating income adjustments:  
23  
24

**Operating Income Adjustment No / Description**

| RUCO Adjustments  | Mohave Water District | Paradise Valley Water District | Sun City Water District | Tubac Water District | Mohave Wastewater District |
|---|-----------------------|--------------------------------|-------------------------|----------------------|----------------------------|
| Company Operating Income as Filed                             | \$416,266             | \$2,193,723                    | \$843,696               | (\$131,793)          | \$90,799                   |
| Adjustment No. 1 Annualizations                               | (11,032)              | 71,230                         | 81,322                  | 2,281                | N/A                        |
| Adjustment No. 2 Reverse Declining Usage                      | 114,427               | 43,787                         | 102,693                 | 19,607               | N/A                        |
| Adjustment No. 3 Include CAP Costs in Base Rates              | N/A                   | (138,082)                      | (549,527)               | N/A                  | N/A                        |
| Adjustment No. 4 Remove APS Estimated Power Costs             | 128                   | 41,231                         | 53,302                  | 13                   | 22                         |
| Adjustment No. 5 Remove ACRM Surcharge and Deferred O&M Costs | N/A                   | N/A                            | N/A                     | (17,337)             | N/A                        |
| Adjustment No. 6 Corporate Allocation Expense                 | 134,211               | 118,248                        | 190,111                 | 14,980               | 21,553                     |
| Adjustment No. 7 Rate Case Expense                            | 29,720                | 26,922                         | 43,684                  | 2,982                | 5,027                      |
| Adjustment No. 8 Tank Maintenance Expense                     | N/A                   | 185,851                        | N/A                     | N/A                  | N/A                        |
| Adjustment No. 9 Depreciation Expense                         | 502,240               | 430,989                        | 1,016,603               | 111,131              | 24,162                     |
| Adjustment No. 10 Property Tax Expense                        | 273                   | 2,503                          | (1,091)                 | 2,821                | 1,209                      |
| Adjustment No. 11 Income Tax Expense                          | (376,894)             | (332,210)                      | (404,314)               | (54,886)             | (28,283)                   |
| Adjustment No. 12 Surrebuttal                                 | 27,687                | (2,944)                        | 18,653                  | (783)                | (1,318)                    |
| Total Operating Adjustments 1 - 12                            | \$420,760             | \$447,525                      | \$551,436               | \$80,809             | \$22,372                   |
| RUCO Adjusted Operating Income (Rounded)                      | \$837,025             | \$2,641,248                    | \$1,395,135             | (\$50,983)           | \$113,169                  |

RUCO's Final Schedules 18.

1           **A)    ANNUALIZATIONS**

2           The Company in this case has utilized a different methodology to account for its  
3 declining usage adjustment than it did in the Chaparral City Water Case.<sup>16</sup> R-10 at 4. In  
4 addition the Company's consultant, Mr. Bourassa has also changed his annualization  
5 methodology from a test year end customer count to an average customer count. R-9 at 21.  
6 It is true that the Company did use an average usage methodology in the Chaparral City  
7 Water Case, however this resulted in a positive increase to test year revenues of \$36,974.  
8 R-10 at 4. In this case the annualization methodology utilized by the Company produces the  
9 following results:

|  | Company Average<br>Customer Annualization<br>Adjustment to Revenues |          |
|--|---|----------|
| Mohave Water District                                | \$  | (1,234)  |
| Paradise Valley Water District                       | \$  | (1,333)  |
| Sun City Water District                              | \$  | (4,369)  |
| Tubac Water District                                 | \$  | (4,914)  |
| Total Additional Test-Year<br>Revenue Generated from | \$  | (11,850) |

18 R-10 at 3.

19           As this table demonstrates by changing the annualization methodology used, the  
20 Company was able to reduce its test year revenues. This suggests that the Company's  
21 methodology was results oriented. The only support for this methodology was a blanket  
22  
23

24 <sup>16</sup> Chaparral City Water Company is a sister Company to EPCOR Water Arizona, and both are ultimately owned by EPCOR Utilities, Inc.



1 seasonality statement. R-10 at 4. However, this argument does not hold water. The  
2 Company is using a test year ending June 30, 2013, therefore, any seasonality effects as a  
3 result of snow birds coming to Arizona in the winter months have been eliminated, and  
4 conversely any seasonality effects related to customers moving in December have also been  
5 eliminated, as would be the case if the test year ended December 30, 2012. R-10 at 4. In  
6 fact, if anything the Company's testimony supports the year-end number count - the  
7 Company's consultant Mr. Bourrassa stated "It is assumed that the year-end number of  
8 customers is the number of customers expected on a going forward basis." R-10 at 6. The  
9 Commission should reject the Company's annualization approach as it is results oriented,  
10 inconsistent with tradition, and there has not been a showing that a change is appropriate  
11 or even necessary. The following chart summarizes RUCO's position:

|  | RUCO End of Test Year<br>Annualization Adjustment to<br>Revenues |          |
|--|--|----------|
| Mohave Water District                                | \$   | (14,168) |
| Paradise Valley Water District                       | \$   | 81,892   |
| Sun City Water District                              | \$   | 107,806  |
| Tubac Water District                                 | \$   | 633      |
| Total Additional Test-Year<br>Revenue Generated from | \$   | 176,163  |

22 R-10 at 3.

23 Staff also advocates for the average customer annualization methodology. However,  
24 Staff witness Brition Baxter was unable to justify why Staff was supporting this methodology.

1 "Q. Okay. Okay. Let's move on. Annualizations I want to talk a little bit about. Is  
2 Staff using the average customer count to annualize, the end of year customer  
3 count to annualize their billing determinants?  
4 A. I am not sure. We used the company's number.  
5 Q. Okay. So if you use the average customer count to annualize billing  
6 determinants, aren't you reducing test year revenues?  
7 A. I am not sure.  
8 Q. Okay. Do you know, has Staff used average customer count to annualize its  
9 billing determinants?  
10 A. In this case or other cases?  
11 Q. In this case.  
12 A. I am not sure on that either."

13 Transcript at 1013.

14 What is sure is that Staff has adopted the Company's annualization methodology.  
15 Based on the facts in this case RUCO believes the end of test year customer counts are the  
16 most accurate, have been adopted by the Commission in prior rate cases and should be  
17 adopted in this case.

## 18 **B) DECLINING USE ADJUSTMENT**

19 The Commission should deny the Company's request for a declining-use adjustment.  
20 It should go without saying that the Commission should not approve a Company's request  
21 for a declining use adjustment unless there is a pattern or trend of declining use. The  
22 Company, as a threshold consideration must show that there is a declining use issue. Only  
23 then should the Commission even consider what do to about it.

24 Declining use adjustments guarantee the Company a certain amount of revenue  
when usage declines. The declining use adjustment is asymmetrical, in that it only  
addresses the Company's concern if usage declines from year to year. If usage increases,  
the ratepayer is not refunded and hence the Company over-collects.

In this case the evidence shows that residential usage has not been declining in all  
districts. In fact, usage has been increasing in the Paradise Valley Water District since the  
Company's last rate case, and usage has trended upward in the Tubac Water District from  
2012 to 2013. R-9, Attachment G.

1  
2 Arizona ratemaking is based on a historic test year - Companies make pro-forma  
3 adjustments to actual test year results and balances to obtain a normal or more realistic  
4 relationship between revenues, expenses and rate base, **based on the known and**  
5 **measureable costs.** A.A.C. R14-2-103(A)(3)(i). Both the Company and Staff have  
6 disregarded the principle of a historic test year here and have projected the declining usage  
7 into future test years.

8 In the recent Chaparral City Water Company case, Staff justified its declining usage  
9 based on the following which was adopted by the Commission in Decision No. 74568. R-9  
10 at 7.

11 *"Staff agrees that a declining usage adjustment is appropriate in this case,*  
12 *but not for the same reasons as the Company. Staffs agreement is based*  
13 *not on the Company's analysis of the three years prior to the test year, but*  
14 *on data provided to Staff by the Company which **showed that***  
15 ***consumption patterns continued to change during the post test year***  
16 ***period.** Staff states that its recommendation to adopt the declining usage*  
17 *adjustment is based on a **known and measurable** change to the test year*  
18 *usage levels, and not on events that predate and are already reflected in*  
19 *test year results.*

20 *For the reasons provided by Staff, the declining usage adjustments*  
21 *proposed by the Company are reasonable and will be adopted. "*

22 Id.

23 The rational used by Staff in that case comported with Arizona's use of a historic test  
24 year for rate making purposes, and Staff's witness Brition Baxter confirmed this:

25 "Q. Okay. And where I am going with this, so you are aware, in the  
26 Chaparral case, the point that I want to make here is that the evidence that  
27 Staff relied on was the data, or, excuse me, what Staff relied on in that  
28 case was data provided to Staff by the company which showed that  
29 consumption patterns continued to change during the post-test year period.

1 And Staff basically, in its recommendation to adopt the declining usage  
2 adjustment, made it based on a known and measurable. You don't have  
3 to have a deep knowledge to understand what those concepts are, correct?

4 A. Yes.

5 Q. And you do understand what those concepts are and what Staff  
6 did just on that part that I just read to you, correct?

7 A. Yes."

8 Transcript 1004.

9 However, Staff made no mention of why it accepted the Company's methodology in  
10 its pre-filed testimony in this case. On cross, Staff witness Brition Baxter testified:

11 "Q. And you stated, when I asked you before, that Arizona works under historic  
12 test year and you could make changes for known and measurable events, correct?

13 A. Yes.

14 Q. And wouldn't you agree with me that as a general principle known and  
15 measurable changes are better than projections for purposes of ratemaking?

16 A. Yes.

17 Q. So in this case, Staff is accepting the company's projection that the declining  
18 usage will continue into future test years, correct?

19 A. Yes.

20 Q. **So why did Staff change its position in the prior case, other than Staff  
21 treats each case differently or individually?**

22 A. **That's the reason, each case is treated on its own merits."**

23 Emphasis Added - Transcript 1005. Staff has never explained what "merits" justify  
24 disregarding the historic test year concept in favor of a future test year.

What is also troubling is Staff's agreement with the Company that the test year  
revenue should also be decreased in essence double counting the revenue decline in the  
test year. Again in the Chaparral City Water Case, Staff recognized the double count  
concept:

*"Staff recommends that events prior to the test year are already  
reflected in test year results and warrant no adjustment."*

1 R-9 at 25.

2 In this case, Staff appears to have over-looked the post-test year events unlike the  
3 Chaparral City Water Company case, to support its position:

4 "Q. Did you even look at the post-test year period in this case?

5 A. I did not.

6 Q. If the post-test year period in this case showed an increase in  
usage, would Staff be willing to make an inclining usage adjustment?

7 A. I am not sure what Staff would do if the post-test year usage showed  
an increase."

8 Transcript at 1006.

9 When Mr. Baxter was presented post-test year data on the issue he agreed that there  
10 was an increase in residential consumption for the 5/8 x 3/4 inch residential customer.  
11 Transcript at 1010. When asked about cross subsidization issues between customer classes  
12 in the Tubac district (residential and commercial) Mr. Baxter wasn't sure. Transcript at 1011.

13 Putting aside the legal impediment of a future test year for the moment, Mr. Baxter  
14 did agree, at least personally, with RUCO that the Company should submit a Plan of  
15 Administration. Transcript at 1012. The purpose of the Plan of Administration is to true-up  
16 projected customer usage with actual known and measureable usage between and within  
17 customer classes, and protect the ratepayer against adverse projections by the Company  
18 and Staff.

19 Further, RUCO recommends the Company file an annual report by March 30th of  
20 each year in this docket showing the increase/decrease in water usage for each customer  
21 class and meter size using a calendar year starting with the 2014 information similar to what  
22 was decided in the Chaparral City Water Company case. R-9 at 26.

1                   **C)     CENTRAL ARIZONA PROJECT ("CAP") COSTS IN BASE RATES**

2  
3           The Commission previously ordered the Company to include in base rates the capital  
4 and delivery charges and the elimination of the CAP surcharge for several of the Company's  
5 districts, two of which are in this filing the Sun City Water District and the Paradise Valley  
6 Water District. In Decision No. 72046 (dated December 19, 2010) for its Sun City Water  
7 District, the Company was ordered by the Commission to .... "include the CAP capital and  
8 delivery charges and the offsetting replenishment credits and costs in its base rates" in the  
9 Company's next rate case. R-9 at 32. Similarly in Decision No. 72208 (dated March 3,  
10 2011), the Commission ordered Paradise Valley Water District in its next rate application to  
11 file "the inclusion in base rates of the CAP capital and delivery charges and the elimination  
12 of the CAP surcharge". ST – 9 at 16.

13           The Company disagreed with RUCO that it had to comply with prior Commission  
14 orders on this issue but the Company finally provided schedules which show the yearly CAP  
15 expenses for both the Sun City and Paradise Valley water districts. Company witness, Mr.  
16 Landering admitted that the Company was out of compliance with these prior decisions. A-  
17 22 at 6.

18           Staff says they take non-compliance issues seriously, but surprisingly recommends  
19 the Company should continue its CAP surcharges. ST – 10 at 1. It also appears that Staff  
20 no longer has concerns with continuing the CAP surcharges, and has unexplicably changed  
21 from its prior recommendations made by Staff analyst, Mr. Darron Carlson, and approved  
22 by Staff's Director, Mr. Steve Olea. R-10 at 12.

23           From RUCO's perspective, the answer is simple, follow what was ordered by the  
24 Commission in the prior two decisions. This is the best recommendation since it still makes

1 sense to do and there is no good reason to proceed in a different direction. Both Decisions  
2 by the Commission recommend the elimination of the CAP surcharges. RUCO has included  
3 the CAP costs for the Sun City and Paradise Valley Water Districts in base rates as was  
4 directed by the two prior Commission decisions, as shown in RUCO Final Schedule 21.

5 ***If the Company and/or Staff disagree with a prior Commission Decision***, they  
6 should have appealed it or sought relief prior to now. Simply ignoring a prior Commission  
7 Decision and seeking to change it in the next rate case by disregarding the prior Commission  
8 directive and making a different recommendation than the last decision is problematic. It  
9 shows little regard for compliance with a Commission decision and if nothing is done, places  
10 into question the conclusiveness and of Commission Decisions. The Commission should  
11 at the very least admonish the Company so that this approach to ratemaking is not  
12 recommended again.

13  
14 **D) APS FORECASTED COSTS**

15  
16 RUCO agrees with the Company that the known and measureable rate increases that  
17 have been approved by the Commission for Mohave Electric Cooperative and UniSource  
18 Electric be included in rates, but disagrees with including projected costs from a study by  
19 APS which is not known and measureable. R-9 at 34.

20 Although RUCO opposes the Company's Power Cost Adjustment Mechanism  
21 ("PCAM"), which will be discussed later, if the Commission is inclined to give the Company  
22 a PCAM, there is no need for this adjustment, as the Company would automatically **pass** all  
23 of the power increases to its ratepayers. R-10 at 12.

1           **E) REMOVE STEP-1 ARSENIC COST RECOVERY MECHANISM ("ACRM")**  
2           **AND DEFERRED OPERATIONS AND MAINTENANCE ("O&M") CHARGES**  
3           **RELATED TO THE TUBAC WATER DISTRICT.**

4           RUCO recommends that the Step-one ACRM surcharge be removed from test year  
5 revenues, and that the remaining deferred O&M charges in the amount of \$101,712 related  
6 to the Arsenic Media be treated as the Company's Step-two ACRM surcharge. R-10 at 13.

7           RUCO further recommends that the Company file a yearly compliance report showing  
8 the amount of surcharges collected and the amount to be collected on a yearly basis, and  
9 that the Company file a final report showing that the Deferred O&M charges of \$101,712  
10 have been fully recovered. Ibid.

11           RUCO disagrees with the Company's assertion that the Step-1 ACRM revenue,  
12 remain in test year metered revenues, as this should not be used as a basis to over-collect  
13 on its Step-1 ACRM, which plant costs have now been included in rate base. R-10 at 14.

14           It is surprising that the Company now wants to undue an agreement between RUCO,  
15 Staff, and Arizona Water Companies related to the Safe Water Drinking Act of 2006 when a  
16 process was approved to help water companies comply with the unfunded federal mandate.  
17 The Step-1 ACRM has always been removed as part of the ACRM process once it has been  
18 included in rate base and is included in a general rate case application.

19           Staff also agrees that the ACRM Step-1 surcharge should be removed from test year  
20 revenues. Transcript 808.



1           **F)     INCOME COMPENSATION EXPENSE - SHORT TERM INCENTIVE PLAN**  
2           **("STIP")**

3           The Company has requested \$452,409 for STIP for the five districts in the current  
4 rate case. This amount includes \$118,431 direct-charged to these districts and the  
5 allocated amounts from EPCOR affiliates. R-24 at 22. RUCO recommends that incentive  
6 compensation expense be removed. R-25 at 8.

7           The Company STIP awards are determined based on the sum of two separate  
8 metrics (Pool A "Managing the business" – operational metrics) and (Pool B "Financial  
9 Profitability" – consolidated financial performance). R-24 at 22-24.

10          The issue of course is whether ratepayers benefit in the incentive plan and should  
11 share in paying this expense. To that end, the Company has come around slightly in its  
12 rebuttal testimony to allow a 10 percent disallowance. R-25 at 3. Ten percent is simply  
13 inadequate. The Company has not shown why Arizona ratepayers should pay more for  
14 having EPCOR and EWAZ' employees showing up for work and conducting their work in a  
15 safe manner. Id. at 8. This is highlighted by the fact that a high portion of customer  
dissatisfaction with EPCOR. Id. at 9.

16          The Commission has historically determined that the costs associated with  
17 Incentive Plans should be shared to some degree. The reason is clear - shareholders also  
18 benefit from the achievement of financial goals. R-24 at 26. Shareholders benefit from the  
19 achievement of expense reduction and expense containment goals between rate cases.  
20 Id. Shareholders and ratepayers can both benefit from the achievement of customer  
21 service goals. The rationale for an allocation to shareholders of utility incentive  
22 compensation expense in the current case appears to be consistent with the Commission's  
23 findings that shareholders should be responsible for some portion of incentive  
24 compensation costs in several rate case decisions. Id.

1 In Decision No. 68487 (February 23, 2006), the Commission adopted Staff's  
2 recommendation for an equal sharing of costs associated with the Southwest Gas  
3 Corporation's ("SWG") Management Incentive Plan ("MIP") expense. For example, in  
4 reaching its conclusion regarding SWG's MIP, the Commission stated in part on page 18  
5 that:

6 We believe that Staff's recommendation for an equal sharing of the costs  
7 associated with MIP compensation provides an appropriate balance between  
8 the benefits attained by both shareholders and ratepayers. Although  
9 achievement of the performance goals in the MIP, and the benefits attendant  
10 thereto, cannot be precisely quantified there is little doubt that both  
11 shareholders and ratepayers derive some benefit from incentive goals.  
12 Therefore, the costs of the program should be borne by both groups and we  
13 find Staff's equal sharing recommendations to be a reasonable resolution.

14 In Decision No. 70011 (November 27, 2007), in UNS Electric rate case Docket No.  
15 G-04204-06-0463 et al, the Commission stated in part on page 27 that:

16 We believe that Staff's recommendation provides a reasonable balancing of the  
17 interests between ratepayers and shareholders by requiring each group to bear  
18 half the cost of the incentive program.

19 In Decision No. 70360 (May 27, 2008), in a UNS Electric, Inc. rate case, Docket No.  
20 E-04204A-06-0783, the Commission stated at page 21 that:

21 Consistent with our finding in the UNS Electric rate case (Decision No. 70011,  
22 at 26-27), we believe that Staff's recommendation provides a reasonable  
23 balancing of the interests between ratepayers and shareholders by requiring  
24 each group to bear half the cost of the incentive program...Given that the  
arguments raised in the UNS Electric case are virtually identical to those  
presented in this case, we see no reason to deviate from that recent decision.

25 In Decision No. 70665 (December 24, 2008), Southwest Gas Company rate case  
26 Docket No. G-01551A-07-0504, the Commission stated at page 16 that:

27 In the last Southwest Gas rate case, as well as several subsequent cases,<sup>3</sup> we  
28 disallowed 50 percent of management incentive compensation on the basis that  
29 such programs provide approximately equal benefits to shareholders and  
30 ratepayers because the performance goals relate to financial performance and

1 cost containment goals as well as customer service elements. (Decision No.  
2 68487 at 18.) In that Decision, we stated:

3 In Decision No. 64172, the Commission adopted Staff's  
4 recommendation regarding MIP expenses based on Staff's claim that  
5 two of the five performance goals were tied to return on equity and  
6 thus primarily benefited shareholders. We believe that Staff's  
7 recommendation for an equal sharing of the costs associated with MIP  
8 compensation provides an appropriate balance between the benefits  
9 attained by both shareholders and ratepayers. Although achievement  
10 of the performance goals in the MIP, and the benefits attendant thereto,  
11 cannot be precisely quantified there is little doubt that both  
12 shareholders and ratepayers derive some benefit from incentive goals.  
13 Therefore, the costs of the program should be borne by both groups  
14 and we find Staff's equal sharing recommendation to be a reasonable  
15 resolution.

16 (Id.) We believe the same rationale exists in this case to adopt the position  
17 advocated by Staff and RUCO to disallow 50 percent of the Company's  
18 proposed MIP costs.<sup>4</sup>

19 <sup>3</sup>See UNS Electric, Inc., Decision No. 70011 (November 27, 2007) at 27; Arizona  
20 Public Service Co., Decision No. 69663 (June 28, 2007) at 27; and UNS Electric, Inc.,  
21 Decision No. 70360 (May 27, 2008) at 21.

22 <sup>4</sup>On the same basis, we will also disallow 100 percent of the Southwest Gas stock  
23 incentive plan ("SIP"). The costs related to similar incentive plans were recently  
24 rejected for APS and UNS Electric. (See Ex. S-12 at 32-34.) As was noted in the  
APS case, stock performance incentive goals have the potential to negatively affect  
customer service, and ratepayers should not be required to pay executive  
compensation that is based on the performance of the Company's stock price.  
(Decision No. 69663 at 36.)

1 In Decision No. 71410 (May 1, 2012 in Docket No. W-01301A-10-0448), which had  
2 addressed rates for the Paradise Valley Water District, a RUCO recommended  
3 disallowance of 30 percent of Annual Incentive Plan cost was not opposed by Staff or the  
4 Company and was adopted by the Commission.

5 In Decision No. 72047 (January 6, 2011 in Docket No. W-01301A-09-0343), which  
6 addressed Sun City Water District rates, RUCO had recommended a 100 percent  
7 disallowance of Annual Incentive Plant cost, rather than a 30 percent disallowance, and  
8 the Commission adopted a 30 percent disallowance.

9 More recently, in Chaparral City Water Company which is an affiliate of EPCOR  
10 (Decision No. 74568 (June 20, 2014), Docket No. W-02113A-13-0118), the Commission

1 agreed with a Staff recommendation to disallow incentive pay noting that the Company failed  
2 to quantify or justify its proposed recovery of incentive pay.<sup>17</sup> The Commission noted:  
3 "Staffs recommended corporate expense allocation removes 100 percent of CCWC's  
4 requested incentive pay. Staff argues that CCWC failed to properly quantify or justify its  
5 calculations of amounts paid under the incentive payment plan." Decision No. 74568 at 24.

6 In the current case, the revised EPCOR incentive compensation request is based on  
7 removing 10 percent, the portion related to financial results, which would be borne by  
8 shareholders, and charging to ratepayers the remaining 90 percent of the "Pool A" incentive  
9 compensation. EPCOR's witness, Ms. Hubbard testified that the incentive plan "Pool A"  
10 payout is based on achievement of safety (30%), customer service (30%), operational  
11 efficiency (30%) and financial (10%) goals. A-8 at 24. However, in the current case, EPCOR  
12 has not justified charging ratepayers for any of these components of incentive  
13 compensation. Ratepayers should not have to pay extra from EPCOR and EWAZ  
14 employees showing up for work and conducting their work in a safe manner.

15 For the component related to customer service and customer satisfaction, EPCOR's  
16 achieved level of customer satisfaction is so poor, that it would be inappropriate and  
17 unconscionable to charge ratepayers for 30 percent of incentive compensation expense  
18 based on that measure.<sup>18</sup>

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19 <sup>17</sup> See Decision No. 74568 at pages 24-25.

20 <sup>18</sup> For example, EPCOR's CONFIDENTIAL response to RUCO 35.04(d)(7) through (9) states that:

21 **[BEGIN CONFIDENTIAL]**

22 **[END CONFIDENTIAL]**

23 Smith Confidential Surrebuttal Testimony at 8-9. Based on this, there is a high proportion of  
24 EPCOR's customers who are less than satisfied. Ratepayers should not be charged extra for  
incentive compensation expense related to customer satisfaction or the lack thereof.

1 The component for "operational efficiency" is basically a reward for over-budgeting  
2 and under-spending for construction and operations. Transcript at 778. Why ratepayers  
3 should pay extra for this type of incentive has not been demonstrated by EPCOR.  
4 Additionally, this 30 percent item could also be viewed as a financial results impact that  
5 results from the Company over-budgeting and under-spending in the period to produce more  
6 income for shareholders. Id. at 778-784. Consequently, RUCO has concluded that EPCOR  
7 has not justified charging ratepayers for any components of this short-term incentive  
8 compensation in the current rate case.

9 There is also no reason why the Commission should change its long standing and  
10 historical approach to Incentive pay. The Company has failed, like in its Chaparral case, to  
11 show why the Commission should allow any of the incentive pay here. RUCO's recommends  
12 that the Commission disallow the STIP expense in its entirety.

#### 13 **G) INCENTIVE COMPENSATION - MID-TERM INCENTIVE PLAN ("MTIP")**

14 The Company has requested \$120,363 for affiliate-charged MTIP incentive  
15 compensation. RUCO is recommending that this amount be disallowed. R-24 at 35. The  
16 Company, in its supplemental response to RUCO 17.31, admitted that there are no district  
17 specific amounts for MTIP incentive compensation. Id. at 34. The EPCOR MTIP incentive  
18 compensation expense is a Corporate Allocation to the districts from EPCOR Utilities Inc.  
19 (EUI). Id. Accordingly, it is reasonable and appropriate to disallow this expense.

#### 20 **H) OTHER OPERATING EXPENSES**

21 RUCO recommends that EPCOR corporate information technology 25 affiliated  
22 charge expense be reduced by \$3,169. Transcript at 772-773. Advertising promotion and  
23 donations expense in the corporate allocation is reduced by \$24,536 for these five districts.  
24 And an amount related to acquisitions of Thunder Mountain and North Mohave acquisition

1 amounting to \$24,310 is also a reduction to expenses. Transcript at 773. RUCO believes  
2 that the company is in agreement with these items. Id. at 773.

3  
4 **I) RATE CASE EXPENSE**

5 RUCO continues to recommend rate case expense in the amount of \$325,000 which  
6 RUCO derived from prior authorized Commission amounts for similarly situation water and  
7 wastewater companies. R-9 at 39. RUCO believes its rate case expense number is  
8 reasonable and should be adopted by the Commission. RUCO further recommends, as is  
9 customary, that rate case expense be normalized over 3 years.

10  
11 **J) TANK MAINTENANCE EXPENSE**

12 The tank maintenance expense is one of the larger outstanding disputes. The  
13 Company's proposal will allow for the recovery of cost estimates, as opposed to "known and  
14 measurable" costs which is the traditional way the Commission has authorized tank  
15 maintenance expense recovery. This is another proposal, which if approved, would shift the  
16 risk to the ratepayer. In other words, should the Company incur less costs than approved,  
17 the ratepayer will not be credited nor refunded the overage and the Company will over  
18 collect.

19 The Company's proposal will cover the costs associated with the stripping, treating  
20 and coating of the tanks over a 14 year period. R-9 at 40. The cost of the maintenance over  
21 the next 14 years is only an estimate - it is not known whether the actual tank maintenance  
22 will follow the Company's estimated schedule. Id. Since the amounts are estimates only,  
23 they are not known or measurable. Id. Adding to the problem, the further removed from the  
24

1 historical test year, the greater the mismatch between rate base, revenues and expenses.  
2 Id. at 11.

3 The Company has not explained or demonstrated why these costs should be **pre-**  
4 **paid** by ratepayers. The Company is not in financial distress, in fact the opposite appears to  
5 be true. R-9 at 43.

6 The Company currently has a tank maintenance program in three districts - Sun City  
7 Water, Havasu Water and Mohave Water., It is clear that the Company has not reinvested  
8 the monies that it has collected from ratepayers into the tank maintenance program. R-9 at  
9 42.

10 The Company's recommendation also will provide the Company an incentive which  
11 apparently Staff condones, to wait for a test year in which the Company expends high  
12 amounts on tank maintenance expense. This incentive is bolstered by the fact that the  
13 amounts that the Company collects from its customer's pre-payments, will be retained by  
14 the Company even if it is not put into the tank maintenance program. There is also no true-  
15 up, and no recovery for ratepayers if the Company misuses the monies it collects from  
16 ratepayers.

17 This reinforces RUCO's recommendation that if the Commission is inclined to have  
18 customers pre-pay for tank maintenance expense under the Company and Staff's  
19 methodology then it be properly tracked separately and any ratepayer money over-collected  
20 and not used for tank maintenance at the end of some future period, in this case 14 years,  
21 be refunded to ratepayers with interest. R-10 at 16.

22 RUCO believes there is another way to handle the tank maintenance expense issue  
23 that would alleviate these very troubling concerns. RUCO acknowledges that tank  
24

1 maintenance expense in any given year may be substantial. At the hearing Mr. Stuck, the  
2 Company's engineer testified:

3 "Q. If it were possible, Mr. Stuck, would the company have any objection, or would  
4 they be agreeable to a provision that would true it up, let's say, every 5 five years,  
5 which seems to be the normal rate case cycle?

6 "A. I don't believe so, but I guess we would need to see some proposals such as that  
7 to fully evaluate it."

8 Transcript at 269.

9 RUCO's witness, Mr. Michlik, explained that the Company could enter into a 5 year  
10 contract with the tank painting vendor, which corresponds to the rate case filing cycle. The  
11 contract could contain clauses, like expenses will not exceed 5 percent of the contract price.  
12 The contract could then be looked at in the context of the Company's next general rate case  
13 and adjusted up or down accordingly. Transcript at 391.

14 In fact the Commission has already approved a similar methodology, in Decision No.  
15 74294 (dated January 29, 2014).

16 "While the Commission's rules require a utility to use a historical test year for its rate  
17 case, they also allow for pro forma adjustments to actual test year figures "to obtain a normal  
18 or more realistic relationship between revenues, expenses and rate base." (See A.A.C. R14-  
19 2-103(A)(3)(i), 4pp. C.) The Commission allows such adjustments to be made for future  
20 expenses when there is evidence establishing that the future expenses are known and  
21 measurable. In this case, the evidence establishes that New River has an obligation to incur  
22 a \$130,000 expense for tank painting to be commenced in the next few months."

23 New River had proposed \$470,000 in normalized tank painting costs to be amortized  
24 over a 15 year period. Decision No. 74294 at 28. There was testimony in the case that a



1 contract had been made between the Company and a vendor concerning \$130,000 of the  
2 \$470,000 total request.

3 In this case, the Commission if it is inclined could recommend a shorter period of 5  
4 years, authorize a total of \$675,755 (i.e. 135,151 x 5 years) that is to be used for the tank  
5 maintenance program. Any overage or underage could be trued-up in the next rate case.  
6 The Company would be required to file as a compliance item in this matter a valid executable  
7 contract made with the vendor if it chooses to enter into such an agreement.

8 **K) PROPERTY TAX EXPENSE**

9 RUCO recommends that a property tax ratio of 18.056 percent based on the passage  
10 of House Bill 2001 which was signed into law on February 17, 2011. R-9 at 45. Based on  
11 Staff's methodology that was approved in Decision No. 74568, which adopted Staff's three  
12 year average of the property tax assessment ratio. The Company continues to use a  
13 property tax assessment ratio of 18.5 percent. RUCO uses the most current property tax  
14 assessment rates on a going-forward basis, while the Company uses outdated property tax  
15 assessment rates. R-10 at 17.

16 **L) RATE DESIGN**

17 RUCO's rate design is summarized in RUCO Final Schedule 31. RUCO's typical bill  
18 is presented in RUCO Final Schedule 32, and Finally RUCO's typical bill with the ACRM is  
19 presented in RUCO Final Schedule 33.

20 The Company's Paradise Valley Water District contain serious design flaws in relation  
21 to cross-over issues. A cross-over issue will occur when a larger sized meter customer pays  
22 less than a smaller sized metered customer at a given gallon usage. R-10 at 18. This renders  
23 the Company's rate design for the Paradise Valley Water District useless.  
24

1 The Company states it will not correct its schedules for these serious rate design flaw.  
2 A-29 at 18.. Since Staff's witness Mr. Baxter accepted most of the Company's adjustments  
3 and methodologies and provided no analysis of his own Staff's rate design is similarly  
4 flawed.

## 5 OTHER ISSUES

### 6 M) PURCHASED POWER ADJUSTMENT MECHANISM ("PPAM")

7 The Company has not provided any evidence that it's purchased power bills are,  
8 increasing substantially and the costs now must be passed through to ratepayers. Only that  
9 another water company was authorized a PCAM in a settlement agreement, and now all  
10 water companies are entitled to this adjustor. R-9 at 48.

11 The Commission in the past laid-out criteria for water and wastewater utility  
12 companies on when to judge whether a Company should receive an Adjustor mechanism.  
13 In Decision No. 68302, the Commission stated the following:

14 *"Staff states that adjustment mechanisms have traditionally been used*  
15 *to mitigate the regulatory lag for volatile, very large expense items, and*  
16 *are useful when a commodity constitutes a utility's largest expense,*  
17 *such as for electric utilities where purchased power is the utility's single*  
18 *largest expense."*  
19 R-9 at 48.

20 Further,

21 *"There is a danger of piecemeal regulation inherent in adjustment*  
22 *mechanisms. Because they allow automatic increases in rates without*  
23 *a simultaneous review of a utility's unrelated costs, adjustment mechanisms*  
24 *have a built-in potential of allowing a utility to increase rates based on*  
*certain isolated costs when its other costs are declining, or when overall*  
*revenues are increasing faster than costs due to customer growth.*  
*Adjustment mechanisms should therefore be used only in extraordinary*  
*circumstances to mitigate the effect of uncontrollable price volatility or*  
*uncertainty in the marketplace."*

In that case the Company's purchased power Adjustor was denied. R-9 at 49.

1 In truth, Companies will seldom if ever ask for a reduction in rates – when was the last time  
2 APS, TEP, or any Electric Co-Op in the State asked for a reduction in rates? For all intents  
3 and purposes, this is a one sided adjustor mechanism that only goes one way, up - which  
4 Staff now supports.

5 From their positions on this, it appears that Staff and the Company do not want to  
6 pass on to customers any of the lowered costs gained through energy efficiency programs.  
7 Any efficiencies gained are retained by the Company and not the ratepayer. R-10 at 19. The  
8 Company even boasts about how it has reduced purchased power cost through energy  
9 efficiency programs. R-10 at 19.

10  
11 **N) AFFORDABLE CARE ACT ADJUSTMENT MECHANISM (“ACAM”)**

12 RUCO continues to recommended denial of the ACAM. The Company has provided  
13 no data, information, studies or any information to support an argument that the Affordable  
14 Care Act is adversely affecting the Company. Moreover these costs are not out of the  
15 Company's control. R-9 at 50.

16  
17  
18 **O) LOW INCOME PROGRAM**

19 RUCO continues to recommend that the Company file a Plan of Administration that  
20 addresses how the low income program will operate in this docket, and provide an  
21 example(s) how the Company intends to fund the low income program (e.g. through a high  
22 block usage surcharge). R-9 at 51.

1           **P)       PLANT IN SERVICE SCHEDULES / INTERNAL CONTROLS**

2           It is customary for Utilities to supply plant additions and retirements dating back to  
3 the Company's last rate case. The only Company that has failed to do so in RUCO's  
4 experience is EPCOR. R-9 at 52. There were also problems in the Company's recent  
5 Chaparral City Water Company case, in fact the hearing had to moved back to reconcile the  
6 Company's plant schedules. R-9 at 53. The Company has established a pattern of not  
7 providing basic schedules to support its rate case filings. Ibid. at 10.

8           This is problematic for many reasons. First, the Company's plant is a primary driver  
9 of the Company's overall revenue increase. Under rate of return methodology, the revenue  
10 requirement is based in large part on the Company's investment in its plant between rate  
11 cases. If the Company cannot support its plant balances, it means its revenue requirement  
12 and rate design are also flawed. Ibid. at 14.

13           Second there are no plant schedules in which to perform audit procedures. This  
14 delays the nature, timing and extent of the audit. R-9 at 54.

15           As mentioned earlier most Companies file plant additions and retirement schedules  
16 on or soon after they file a rate case application. RUCO, Staff and other intervenors, then  
17 select plant balances by year and NARUC account number for audit work, which requires  
18 the Company to support its plant additions usually through invoices or other supporting  
19 documentation. However, RUCO could not get to this point for a long time, because the  
20 Company was continually **correcting** its plant numbers. For example, in the Paradise Valley  
21 Water District the amount presented by the Company for NARUC account 331 Transmission  
22 and Distribution Mains (TD Mains 10 inch to 16 inch) was \$8,382,610 in a prior iteration, and  
23 in a later iteration the balance was \$9,382,610 at the end of calendar year 2011. This error  
24 was not just isolated to a specific NARUC account or district, but was prevalent throughout

1 the Company's continual revision of its schedules. After submitting the first version of the  
2 6th iteration, the Company stopped updating the numbering of future revised iterations, but  
3 continued to provide updates to all of its district plant schedules (RUCO estimates the  
4 Company submitted a total of 15 iterations). The parties are severely disadvantaged when  
5 the Company is creating new and supplemental plant schedules during the rate case. R-9  
6 at 54. This is frankly inexcusable. R-9 at 56.

7 The National Association of Regulatory Utility Commissioners ("NARUC") Uniform  
8 System of Accounts (USoA) states that:

9 *"All books of accounts, together with records and memoranda*  
10 *supporting the entries therein, shall be kept in such a manner as to support*  
11 *fully the facts pertaining to such entries. The books and records referred to*  
12 *herein include not only the accounting records in a limited technical sense,*  
13 *but also all other records, reports, correspondence, invoices, memoranda*  
14 *and information useful in determining the facts regarding a transaction."*

15 R-9 at 56.

16 Further, the Arizona Administrative Code states the following:

17 *"A. A.A.C. R14-2-102 provides in relevant part:*

18 *B. All public service corporations shall maintain adequate accounts*  
19 *and records related to depreciation practices, subject to the following:*

20 *1. Annual depreciation accruals shall be recorded.*

21 *2. A separate reserve for each account or functional account shall be*  
22 *maintained.*

23 *3. The cost of depreciable plant adjusted for net salvage shall be*  
24 *distributed in a rational and systemic manner over the*  
*estimated service life of such plant.*

*4. Public service corporations having less than \$250,000 in annual*  
*revenue shall not be required to maintain depreciation records*  
*by separate accounts but shall make annual composite accruals*  
*to accumulated depreciation for total depreciable plant."*

A.A.C. R14-2-411 also states the following:

1        *"D. Accounts and records*

2        *1. Each utility shall keep general and auxiliary accounting records*  
3        *reflecting the cost of its properties, operating income and expense,*  
4        *assets and liabilities, and all other accounting and statistical data*  
5        *necessary to give complete and authentic information as to its*  
6        *properties and operations.*

7        *2. Each utility shall maintain its books and records in conformity with*  
8        *the NARUC Uniform Systems of Accounts for Class A, B, C and D*  
9        *Water Utilities.*

10       *3. A utility shall produce or deliver in this state any or all of its formal*  
11       *accounting records and related documents requested by the Commission.*  
12       *It may, at its option, provide verified copies of original records and documents."*

13       R-9 at 56.

14       In addition to the plant schedules not being accurate and out of compliance with  
15       NARUC accounting requirements, RUCO has additional concerns regarding the internal  
16       controls over all aspects of financial reporting. For example, the Company has not been in  
17       compliance with prior regulatory requirements, there were adjustments to retained earnings  
18       which is not appropriate except in very limited circumstances, the timeliness of reporting is  
19       questionable and the accumulated deferred income tax account was not stated correctly.

20       R-19 at 8.

21       In summary, RUCO is concerned with the Company's internal controls over their plant  
22       records, and their lack of compliance with the NARUC USOA and the Administrative Code.  
23       R-9 at 57. This haphazard internal control system ends up creating a lot of additional work  
24       for the parties and additional expense for ratepayers

      RUCO continues to recommend the following:

1. EPCOR include in all future rate case applications (for all districts) plant

schedules that include plant additions, retirements, and accumulated depreciation

balances by year and by NARUC plant account number that reconcile to the prior

Commission decision.

1 2. EPCOR file an accounting action plan that will correct its lack of internal  
2 controls over its plant schedules and records, within 90 days of a decision in this  
3 docket. DT – 57 at 28.

4 3. The adoption of RUCO's recommended rate case expense.

5 4. In addition to the prior recommendations RUCO is also recommending that the  
6 Commission require that EPCOR Water Arizona be audited by an independent external auditing  
7 firm and that their accounts be reviewed for correctness and accuracy and even more importantly,  
8 that internal controls are in place and working.

9  
10 **COST OF CAPITAL**

11 **1) CAPITAL STRUCTURE**

12 EPCOR currently has approximately 60 debt and 40 percent equity in its capital structure  
13 which is not significantly different than the proxy companies used in our analysis. R-21  
14 Attachment 1. RUCO recommends the Commission adopt the Company's actual capital  
15 structure.

16 **2) COST OF EQUITY/COST OF DEBT**

17 RUCO is recommending a Cost of Common Equity of 8.91 percent and a Cost of  
18 Debt of 4.60 percent. R-21 at 3. RUCO is recommending a weighted average cost of capital  
19 of 6.09 percent. Id. RUCO's Cost of Equity recommendation is derived from the application  
20 of three cost of equity models. The Discounted Cash Flow ("DCF") Model - 8.74 percent, the  
21 Capital Asset Pricing Model ("CAPM") - 7.48 percent, and the Comparable Earnings Model  
22 – 10.50 percent. Id. The 8.91 percent represents the weighted average of the three models  
23 and is fair and reasonable in this case. The Company argues for the most part that RUCO's  
24 inputs in the various cost of capital methodologies are incorrect. A-33 at 42. Ms. Ahern's

1 criticism that the DCF model has a tendency to miss-specify investors required rate of  
2 returns is misplaced. A-32 at 22. Informed investors are aware that most utilities have their  
3 rates set based on the book value of their assets. The Company also claims that the DCF  
4 model produces understated results. Id., A-32 at 26. This is simply not the case as RUCO's  
5 DCF results are slightly higher than that of the Company.

6 The Company also prepared a Risk Premium Model and a Capital Asset Pricing  
7 Model ("CAPM") in addition to its DCF model. A-32 at 3. Ms. Ahern prepared two types of  
8 risk free models in her analysis. The first method, Predictive Risk Premium ("PRPM™")  
9 produced an 11.68 percent cost of equity and the risk premium using the market approach  
10 produced a 9.96 percent cost of equity. A-32, Schedule 7. As Ms. Ahern explains on page  
11 35 of her direct testimony, the RPM derived common equity is 11.25 percent is derived by  
12 giving three times the greater weight to the PRPM™ results because the PRPM™ is based  
13 on a minimum of restrictive assumptions. The PRPM™ was presented in the Chaparral City  
14 Water Company's most recent rate case and was not recommended in the final Decision.  
15 When ask the question has this model been accepted by any regulatory agency, she replied  
16 "obliquely," Transcript at 618. (In other words the PRPM™ model has not been accepted  
17 by any other regulatory agency). When compared to the DCF model and the CAPM, the  
18 PRPM™ calculated cost of equity is 288 basis points more than the DCF and 132 basis  
19 points above the CAPM. This is just a way to increase the cost of equity by presenting a  
20 model that is untried and untested.

21 In preparing her CAPM, Ms. Ahern testified that she has "averaged the prospective  
22 and historical yields of U.S. Treasury Securities because the current U.S. Treasury securities  
23 market, the Federal Bank is artificially and indefinitely keeping interest rates low until certain  
24 economic thresholds are met: i.e. unemployment falls to 6.5% and inflation rises to 2.5%,



1 amid concerns over struggling U.S. Economy." A-32 at 37 By averaging both historical and  
2 prospective (over a 30 year period) her risk free rate is 4.31 percent compared to the current  
3 rate of 2.91 percent. The risk free rate used in her analysis is purely a speculative rate and  
4 cannot be relied on based on current investor's expectations in the market place. R-21 at  
5 22.

### 6 **3) RISK PREMIUMS**

7 The Company has included upward adjustments of 24 basis points for credit risk and  
8 30 basis points to reflect the Company's greater relative business risk primarily due to its  
9 smaller size capital intensity. A-33 at 45. The Company has defined business risk as "the  
10 riskiness of a company's common stock without the use of debt and/or preferred capital. A-  
11 31 at 6. Examples of business risk include quality of management, regulatory environment,  
12 capital intensity, and size, all of which have a direct bearing on earnings. Transcript at 585.  
13 In Ms. Ahern's discussion on business risk she primarily discusses capital intensity and size  
14 in reaching her conclusions. A-31 at 6-8. As discussed in RUCO's testimony, EPCOR has  
15 paid out \$23,962,545 in dividend payments, or 80.31 percent, of its earnings of \$29,837,000,  
16 since purchasing the systems in 2012, in dividend payments to its parent. This compares to  
17 55 percent being distributed in dividend payments for the proxy companies that Ms. Ahern  
18 and RUCO both used in their analysis of the water industry when performing cost of equity  
19 analysis. R-21 at 22-24. The Company should retain a larger percentage of its retained  
20 earnings to support its infrastructure requirements and should not be awarded a business  
21 risk adjustment in this case.

22 EPCOR has also requested a credit risk adjustment of 30 basis points. Financial risk  
23 is the additional risk created by the introduction of senior capital, i.e. debt and preferred  
24 stock, into the capital structure. The higher the proportion of senior capital in the capital

1 structure, the higher the financial risk which must be factored into the common equity cost  
2 rate. R-21 at 14. EPCOR currently has approximately 60 percent debt and 40 percent equity  
3 in its capital structure which is not significantly different than the proxy companies used in  
4 our analysis. R-21 Attachment 1. Even though EPCOR Utilities has an A credit rating with  
5 DBRS rating agency and was recently been upgraded to an A- rating by S&P, the Company  
6 continues to believe that a credit risk adjustment of 30 basis points is appropriate. The recent  
7 rating agencies reports and upgrades is an indication of the business and financial strength  
8 of EWAZ's parent Company. The business and credit risk of a wholly-owned, cost of service  
9 based, rate regulated monopoly utility operating in the U.S. such as EWAZ is comparable to  
10 that of its parent. A-32 at 16. Another creditable reason for disallowing a credit risk  
11 adjustment in this case is EWAZ's interest rate on long term debt is a very favorable 4.29  
12 percent. This compares to the cost of debt for APS most recent four corners rate rider  
13 transaction of 4.725 percent and UNS cost of debt for the Gila River purchase transaction  
14 of 5 percent. R-22 at 7. This being the case, there is no reliable basis for imputing a credit  
15 risk adjustment to EWAZ's return on equity in this case. The Company is remitting excessive  
16 dividends to its parent and has a very attractive interest rate on its long term debt.  
17 Ratepayers in Arizona should not have to pay risk premium adjustments when it appears  
18 that EPCOR is out-performing the proxy public utility companies that were used for  
19 comparative purposes in our analysis.

1

2 **4) STAFF'S ECONOMIC ADJUSTOR**

3 An economic adjustor of 60 basis points was added to the Staff's calculation of cost  
4 of capital. Staff calculated an actual cost of equity of 8.90<sup>19</sup> percent, compared to RUCO's  
5 cost of equity of 8.91 percent, and then added an additional 60 basis points for what the  
6 Staff refers to as an "Economic Adjustor." When asked by ALJ Nodes,

7 Q. Okay. And you don't know how 60 basis points was derived to be a proxy for  
8 these, the uncertainty in the economy? And is it the American economy? Is it the worldwide  
9 economy? What is it?

10 A. I believe it was to give recognition both to the domestic as well as the  
11 international economy, the broader global view, I suppose. It was, that was my  
12 understanding at least.

13 Q. Okay. But you, since you have been recommending this adjustment, upward  
14 adjustment in the last couple of years, it was just dictated to you that you are suppose to  
15 perform your cost of equity analysis and then slap on this extra 60 basis points basically?

16 A. I don't know that I would use the word slap. But it was, it was an additional  
17 component, upward component to the cost of equity.

18 Q. Without respect to the individual utility company but just in general for all utility  
19 companies until further notice, there is an adder of 60 basis points to reflect uncertainty in  
20 the domestic and worldwide economy?

21 A. Yes.  
22  
23

24 <sup>19</sup> Transcript at 661

1 Transcript at 700

2 Neither the Company's business risk adjustment of 24 basis points and credit risk  
3 adjustment of 30 basis points, nor the Staff's economic adjustor of 60 basis points have  
4 merit in this case and should be rejected. RUCO's cost of equity of 8.91 percent should be  
5 approved by the Commission as well as the overall cost of capital of 6.09 percent.

6  
7 **SYSTEM IMPROVEMENT MECHANISM ("SIB")**

8 The Company should not be awarded a SIB mechanism based on facts and  
9 circumstances specific and unique to this case. When a Company has not maintained its  
10 infrastructure up to industry standards, or in EPCOR's case purchased existing systems,  
11 should the Commission reward the Company by approving a SIB mechanism? In EPCOR's  
12 case the answer is clearly no.

13 EPCOR has requested SIB projects totaling \$28,246,638 be approved for Sun City  
14 Water District, Mohave Valley Water District and Paradise Valley Water District. R-18 at 12.  
15 This SIB request represents approximately a 41 percent increase in the rate base of Sun  
16 City, an increase in rate base for the Mohave Valley System of 43 percent and an increase  
17 in rate base of 17 percent for its Paradise Valley System. This represents a very significant  
18 increase in rate base, and very significant increase in ratepayer rates, without the benefit of  
19 a fair value determination. For comparative purposes the Company, in its final schedules  
20 filed, is requesting an increase in revenues and rates for its Sun City System of \$1,125,509  
21 while the SIB revenues, assuming that the projects are completed, placed in service and  
22 approved for recovery, will total \$1,080,493. See Chart below. In the Mohave Valley System  
23 the Company is requesting an increase in revenues and rates of \$1,864,809 while the SIB  
24 will generate an additional revenue increase of \$1,082,008 and in the Paradise Valley

System the Company is requesting a revenue increase of \$554,266 and the SIB will generate additional revenues of \$670,780. See Chart below. Overall for the three systems the Company is requesting an increase in revenues of \$3,544,584 and the SIB mechanism assuming once again, that all projects are complete and placed in service as requested, will generate an additional revenue increase over the five year SIB period of \$2,833,281. See Chart Below.

**RATE CASE REVENUES COMPARED TO SIB REVENUES**

| (A)                | (B)                             | (C)                                   | (D)                            |
|--------------------|---------------------------------|---------------------------------------|--------------------------------|
| <u>System Name</u> | <u>Company<br/>Revenue Inc.</u> | <u>SIB Projects<br/>Revenues Inc.</u> | <u>Additional<br/>Increase</u> |
| Sun City           | \$ 1,125,509                    | \$ 1,080,493                          | 96.00%                         |
| Mohave Valley      | \$ 1,864,809                    | \$ 1,082,008                          | 58.02%                         |
| Paradise Valley    | \$ 554,266                      | \$ 670,780                            | 121.02%                        |
| <u>Totals</u>      | <u>\$ 3,544,584</u>             | <u>\$ 2,833,281</u>                   | <u>79.93%</u>                  |

Col. (B); Company Final Schedules Filed

Col. (C); R-18 at 16

Col. (D); Col.(C) divided by Col. (B)

The increase in revenues generated from SIB projects is basically 80 percent of the revenues being requested in the general rate case application. Should the ratepayer be informed at the time the Company files a rate application that not only is the Company requesting a significant increase in the monthly rates but also that the SIB mechanism will generate a significant increase in rates over the next five year period assuming that the SIB is approved by the Commission and the expenditures for SIB projects are expended as planned? The Company made no attempt to calculate the effects on ratepayers as RUCO did. R-18 Schedule 2. In fact, the Company indicated that there are too many variables,

1 including cost of capital, to calculate the effects of the SIB. A-9 at 25. This statement lacks  
2 merit. Using this logic, how can the Company calculate revenue requirements as it too is  
3 calculated based on cost of capital. The Company should not be awarded a SIB in this case.

4 A SIB mechanism is awarded by the Commission for the purpose of replacing old  
5 infrastructure that has become too costly to maintain. The major sources of funding  
6 infrastructure projects and improvements include debt, equity infusions and/or retained  
7 earnings generated from Company earnings, or free cash flow. A-32 at 1 Since EPCOR  
8 purchased the systems in February 2012, the Company has earned \$29,837,000 in net  
9 income through and including June 30, 2014, and has distributed \$23,962,545, or 80.3  
10 percent, in dividends to its parent company. R-21, Attachment 5. This is in contrast to the  
11 "proxy company's"<sup>20</sup> dividend payments to its shareholders that were approximately 55  
12 percent. R-21, Attachment 4. It appears that EPCOR is more interested in keeping the  
13 citizens of Edmonton well fed by paying dividends well beyond the water industry standard.  
14 R-18, Attachment 3. Is this fair and equitable to the ratepayers in Arizona? Absolutely not.

15 Included in the Company's filed Plan of Administration (POA) were three  
16 requirements, one of which was water loss exceeding 10 percent. Sun City Water, Paradise  
17 Valley Water and Mohave Water are experiencing water losses of 6.9 percent, 5.9 percent  
18 and 9.4 percent respectively. These districts do not qualify for SIB recovery under this  
19 eligibility requirement. R-18 at 9.

20 The second requirement as presented in the Company's POA include assets that  
21 have remained in service well beyond their useful lives. Ibid. In EPCOR's case many of the  
22  
23

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24 <sup>20</sup> Companies selected for comparative purposes. See R-21, Cost of Capital Testimony

1 assets have remained in service beyond their useful lives as evidenced by the excess  
2 depreciation taken in the plant asset accounts for these three systems. However, there was  
3 no evidence presented that these assets require excessive maintenance expense to remain  
4 in service. In fact, the systems have been well maintained otherwise they would be  
5 experiencing additional water loss. The Commission should not approve a SIB under this  
6 criteria and the SIB should be rejected.

7 The third criteria in the Company's POA is the typical "catch all" as it has been referred  
8 to. Basically the Company can request a SIB for any type of asset if its repair costs increase,  
9 the asset fails, or just needs replacement prior to reaching the end of its useful life.  
10 Requesting recovery through a catch all eligibility requirement truly stretches the purpose  
11 and the intention of the original DSIC and now the SIB, and further strengthens RUCO's  
12 recommendation to reject a SIB in this case. Ibid.

#### 14 **RUCO's ENGINEERING REVIEW**

15 RUCO's engineering review indicated that the projects included in EPCOR's request  
16 are not justifiable and should not be approved by the Commission in this case. For example,  
17 rather than providing a detailed pipe condition analysis, for the projects included in the SIB  
18 request, the Company has provided Nessie curves that the Environmental Protection  
19 Agency defines as "useful for forecasting capital expenditure needs, but are based on the  
20 design life of the pipelines and not on structural condition or failure considerations. The EPA  
21 also states that the Nessie curve "is used primarily for long-term capital planning and is not  
22 applicable for the annual prioritization of pipeline renewal projects." The Company is  
23 proposing to replace mains for the Mohave Valley and Paradise Valley Water Districts at a  
24 rate of 2.1 miles per year. A review of historic main replacement shows that the Company

1 has replaced mains at a rate of 1.8 miles per year so the SIB will not result in any applicable  
2 replacement rate of mains. As such, the Company has not shown that there is a special  
3 need that the SIB is addressing. R-26 at 21 – 23.

4 The program proposed under the SIB with respect to meters, services and valves is  
5 much more aggressive than history suggest it needs to be. The proposed number of valves  
6 targeted for replacement is more than triple the historic replacement rate. For services the  
7 Company proposes to double the average amount of services being replaced as compared  
8 to historic levels. The Company reports that it has replaced over 4,000 meters on average  
9 in the last two years in the Mohave Water and Sun City Water Districts. Under the SIB, it  
10 proposes to replace just over 4,000 per year. Obviously, since the Company is already  
11 replacing meters at a rate greater than that being requested under the SIB there is no special  
12 need that it needs the SIB in order provide better service. Moreover, a review of the SIB  
13 reports for each of these Districts shows that the justification for the meter replacement is to  
14 improve meter accuracy. Increasing meter accuracy will result in increased revenues to the  
15 Company. Without an offering of sharing the increased revenues with the ratepayers, this  
16 is unfair and a clear violation of the matching principal. Id.

17 For these reason the SIB is not justifiable on an engineering basis and the proposed  
18 program is being done out of desire to reduce losses and grow revenues and net income  
19 and not needed for repairs.

20 In addition to those issues that are specific to this case RUCO has opposed a SIB  
21 mechanism in past rate case applications, and continues to oppose a SIB mechanism, for  
22 the following reasons (1) the SIB inappropriately shifts risk from the Company to the  
23 ratepayer without adequate financial compensation to the ratepayer; (2) the SIB is not an  
24 adjustor mechanism; (3) the SIB will increase the Company's fair value rate base without



1 any determination of fair value; (4) the Company has not requested interim rates; (5) the SIB  
2 is not in the public interest; (6) individual circumstances of the case and (7) the Company  
3 does not set aside depreciation expense. R-18 at 4.  
4

5 **1) THE SIB SHIFTS RISK FROM THE COMPANY TO THE RATEPAYER**  
6 **WITHOUT ADEQUATE FINANCIAL CONSIDERATION TO THE RATEPAYER**

7 RUCO opposes the SIB mechanism because ratepayers are not adequately  
8 compensated for the additional risk associated with the SIB and because it is illegal. The  
9 SIB mechanism reduces regulatory lag in favor of EPCOR because the Company will not  
10 have to wait until new rates go into effect to recover a return on SIB eligible plant or the  
11 depreciation expense associated with it. R-18 at 16. However, any actual cost savings,  
12 such as lower operating and maintenance expenses, attributable to the new plant are not  
13 truly captured by the mechanism and are not adequately flowed through to ratepayers. The  
14 reason for the mismatch is the SIB filings will consider eligible plant placed in service after  
15 the time period considered in the rate case. Hence, the operating expenses associated with  
16 the SIB plant as well as all of the other rate case elements normally considered in a rate  
17 case will not be factored into the calculation. Transcript at 554. This mismatch works against  
18 the ratepayer's interests and assures that ratepayers will not pay their actual cost of service  
19 and will pay more over time.

20 Ratepayers will be paying for the recovery of and return on routine plant placed into  
21 rate base in between rate cases that the ratepayer would not otherwise pay until the next  
22 rate case. To the extent the ratepayer receives a benefit through the efficiency credit on the  
23 return associated with the SIB related plant that paltry benefit will only accrue until the next  
24

1 rate case filing when the relevant plant is rolled into the rate base and subject to the cost of  
2 capital awarded in the next rate case.

3 Another financially related argument advanced in support of the SIB is that the SIB  
4 will promote rate gradualism. There is no doubt that the rates will increase gradually  
5 between rate cases if a SIB is approved in this case. However, ratepayers will end up paying  
6 more over time as a result of the SIB. For example, assume that the Commission approves  
7 a SIB surcharge in year two resulting from completion of SIB approved projects in year one.  
8 For the three subsequent years following the increase in rates the ratepayer will be paying  
9 the rate and return that was approved by the Commission as a SIB surcharge. After year  
10 five the company files a rate application and the cost of the SIB plant and the accumulation  
11 depreciation becomes part of the rate base when filing the rate case application. The cost  
12 of the SIB plant and accumulated depreciation that is included in rate base will be the same  
13 if the Company has been granted a SIB or has not been granted a SIB. As a result, the  
14 ratepayer has paid for three years a SIB surcharge and a return that would not have been  
15 incurred under traditional rate making principles.

## 17 **2) THE SIB IS NOT AN ADJUSTOR MECHANISM**

18 Commission only change a utility's rates in conjunction with making a finding of the  
19 fair value of the utility's property.<sup>21</sup> However, Arizona's courts recognize that, "in limited  
20 circumstances," the Commission may engage in rate making without ascertaining a utility's  
21  
22

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23 <sup>21</sup> Arizona Constitution. Art. XV, § 14; *Simms v. Round Valley Light & Power Company*, 80 Ariz. 145, 151, 294  
24 P.2d 378, 382 (1956); see also *State v. Tucson Gas*, 15 Ariz. 294, 308; 138 P.781, 786 (1914); *Arizona  
Corporation Commission v. State ex rel. Woods*, 171 Ariz. 286, 295, 830 P.2d 807, 816 (1992).

1 rate base.<sup>22</sup> One of those circumstances exists where the Commission has established an  
2 automatic adjustor mechanism. *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 535, 578  
3 P.2d 612, 616; *Residential Util. Consumer Office v. Arizona Corp. Comm'n* ("Rio VeR-13e"),  
4 199 Ariz. 588, 591 ¶ 11, 20 P.3d 1169, 1172. An automatic adjustor mechanism permits  
5 rates to adjust up or down "in relation to fluctuations in certain, narrowly defined, operating  
6 expenses." *Scates* at 535, 578 P.2d 616. An automatic adjustor permits a utility's rate of  
7 return to remain relatively constant despite fluctuations in the relevant expense. An  
8 automatic adjustor clause can only be implemented as part of a full rate hearing. *Rio Verde*  
9 at 592 ¶ 19, 20 P.3d 1173, *citing Scates* at 535, 578 P.2d 616.

10 The Commission has also defined adjustor mechanisms applying to expenses that  
11 routinely fluctuate widely. In a prior decision in which it eliminated APS' fuel and power  
12 adjustor, the Commission stated:

13 The principle justification for a fuel adjustor is volatility in fuel  
14 prices. A fuel adjustor allows the Commission to approve  
15 changes in rates for a utility in response to volatile changes in  
fuel or purchased power prices without having to conduct a rate  
case. (Decision No. 56450, page 6, April 13, 1989).

16 The Commission went on to discuss the undesirability of such adjustors because they can  
17 cause piecemeal regulation that is inefficient and undesirable. *Id.* at 8. See also *Scates* at  
18 534, 578 P.2d 615.

19 In the subject case, the SIB clearly is not an adjustor mechanism – its purpose is not  
20 to account for fluctuating operating expenses. Its purpose is to allow for recovery of plant  
21

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22  
23 <sup>22</sup> *Residential Utility Consumer Office v. Arizona Corporation Commission*, 199 Ariz. 588, 591 ¶11, 20 P.3d  
24 1169, 1172 (App. 2001).

1 costs which increases rate base and thereby increases operating income – not operating  
2 expenses. Unlike an adjustor, the SIB does not allow for rates to adjust “in relation to  
3 fluctuations in certain, narrowly defined, operating expenses.” Moreover, the SIB only  
4 permits rates to adjust up, not down as the result of allowing for the SIB related plant  
5 recovery.

6 Even if one could set aside the argument that Arizona’s courts have only recognized  
7 adjustors for very limited operating expenses and not for operating income, the SIB  
8 mechanism still would not qualify as an adjustor because the justification for the mechanism  
9 is not the volatility in the price of the plant. As explained, the concern here is the amount of  
10 the investment, and no case law parities the need for an adjustor mechanism with the  
11 magnitude of investment in plant. The SIB is not an adjustor mechanism nor should the  
12 exception be expanded in any manner to treat it as such.

13  
14 **3) THE SIB WILL INCREASE THE COMPANY’S FAIR VALUE RATE BASE**  
15 **WITHOUT ANY DETERMINATION OF FAIR VALUE**

16 Having established that the SIB does not meet any of the criteria required by  
17 Arizona’s Courts to side-step the Constitution’s fair value requirement, the question then  
18 becomes whether or not the SIB complies with the Constitution’s fair value requirement.  
19 First, it is important to recognize what the SIB is – it is a mechanism, not an adjustor  
20 mechanism, which will allow for the recovery of, and a return on routine plant in between  
21 rate cases, needed to address the Company’s normal and recurring plant and improvement  
22 needs.

23 The SIB mechanism itself will be established as part of the pending rate case. Within  
24 12 months of the date of the Commission’s final decision, EPCOR will be able to file a

1 request to implement the SIB surcharge. The Company will be able to file for the SIB  
2 surcharge no more than five times between rate case decisions. The Commission will  
3 ultimately consider and then may approve each surcharge filing. The Commission, however,  
4 will not be making a new FVRB finding as part of each surcharge filing. It will be updating  
5 the prior fair value finding with the new SIB related plant and associated depreciation  
6 expense. It will not consider other expenses and revenues in the calculation. The SIB will  
7 do far more than simply pass on increasing costs to the Company - it will allow for increasing  
8 rates in between rate cases based on the costs of routine plant effectively increasing the fair  
9 value rate base without a meaningful consideration of fair value. The fact that the Company  
10 will be subject to an annual earnings test and will have to file balance sheets, income  
11 statements and other financial information does not cure the constitutional infirmity.

12 The financial filings are covered in SIB Schedule D which appears to be the answer  
13 to the fair value issue from the proponents' perspective. RUCO's perspective is different—  
14 the facts are the facts and the fact is that each SIB filing will not result in a meaningful FVRB  
15 finding nor will there be any finding by the Commission of what fair value is:

16 "It is clear . . . that under our constitution as interpreted by this  
17 court, the commission is required to find the fair value of (the  
18 utility's) property and use such finding as a rate base for the  
19 purpose of calculating what are just and reasonable rates. . . .  
20 While our constitution does not establish a formula for arriving at  
21 fair value, it does require such value to be found and used as the  
22 base in fixing rates. The reasonableness and justness of the  
23 rates must be related to this finding of fair value." Simms v.  
24 Round Valley Light & Power Co., 80 Ariz. 145, 151, 294 P.2d  
378, 382 (1956).

22 Schedule D will show an analysis of the impact of the SIB plant on the fair value rate  
23 base, revenue, and the fair value rate of return. S-6, POA at 5. This provision was obviously  
24 put in to satisfy *Scates*, but it does not go far enough:

1 We do not need to decide in this case whether as a matter of  
2 law there must be a de novo compliance with all provisions of  
3 the order in connection with every increase in rates. The  
4 Commission here not only failed to require any such  
5 submissions, but also failed to make any examination  
6 whatsoever of the company's financial condition, and to make  
7 any determination of whether the increase would affect the  
8 utility's rate of return. There may well be exceptional situations  
9 in which the Commission may authorize partial rate increases  
10 without requiring entirely new submissions. We do not decide in  
11 this case, for example, whether the Commission could have  
12 referred to previous submissions with some updating or whether  
13 it could have accepted summary financial information. *We do  
14 hold that the Commission was without authority to increase the  
15 rate without any consideration of the overall impact of that rate  
16 increase upon the return of Mountain States, and without, as  
17 specifically required by our law, a determination of Mountain  
18 States' rate base. Simms v. Round Valley Light & Power Co., 80  
19 Ariz. 145, 294 P.2d 378 (1956); Ariz.Const. Art. 15, section 3;  
20 A.R.S. section 40-250.* The Commission not only failed to make  
21 any findings to support its conclusion that the increases were just  
22 and reasonable, but it received no evidence upon which such  
23 findings could be based. *Scates* at 537, 578 P.2d 618.  
24 (Emphasis added).

14 While the SIB Schedule (D) may show the impact of the SIB plant on the rate base,  
15 the revenue and the fair value rate of return, the Commission will not, as required by law,  
16 make a meaningful finding of fair value and use that finding as a rate base for the purpose  
17 of establishing rates. In the Phase II Eastern Division case, Schedule D shows the rate base  
18 (O.C.L.D.) but it only shows the capital costs and the depreciation expense associated with  
19 the plant additions. Decision No. 73938, Settlement Agreement, Schedule D. Hence, the  
20 SIB filings will only consider one piece – the SIB plant (and depreciation expense). It will  
21 not consider the operating expenses associated with that plant, the working capital, etc. in  
22 the calculation. The operating expenses that will be included in the rates that the  
23 Commission will approve after each SIB filing will be the operating expenses ultimately  
24 approved in the Decision in this case - operating expenses from a completely different period

1 than the time period of the SIB plant under consideration. In sum, there is no tie back to  
2 fair value and the SIB raises the specter of single issue ratemaking which was a concern of  
3 the *Scates* Court. *Scates* at 534, 578 P.2d. 615. The SIB mechanism is single issue  
4 ratemaking; it is not fair value ratemaking.

5 Decision No. 73938 added an earnings test calculation. Decision No. 73938 at 51.  
6 While an earnings test will provide the Commission with a measure of the Company's  
7 earnings at a designated point in time, it will not cure the constitutional fair value infirmity.  
8 The earnings test is an after-the-fact indicator of whether the Company's actual rate of return  
9 exceeded its authorized rate of return looking back over a designated time period. *Id.* An  
10 earnings test is not relevant to an actual finding of fair value. There are other provisions of  
11 the Eastern Division Settlement ("Eastern Division Settlement") which will assure  
12 Commission oversight and approval of the SIB filings but nothing that requires a meaningful  
13 finding of fair value as required by Arizona's Constitution. The SIB is illegal and should be  
14 rejected.

#### 16 **4) THE COMPANY HAS NOT REQUESTED INTERIM RATES**

17 The only other circumstance where the Commission may engage in rate making  
18 without ascertaining a utility's rate base involves requests for interim rates.<sup>23</sup> The  
19 Commission's authority to establish interim rates is limited to circumstances in which 1) an  
20 emergency exists; 2) a bond is posted guaranteeing a refund if interim rates are higher than  
21 final rates determined by the Commission; and 3) the Commission undertakes to determine  
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<sup>23</sup> *Scates v. Ariz. Corp. Comm'n*, 118 Ariz. 531, 533-35, 578 P.2d 612, 614-16 (App. 1978).

1 final rates after making a finding of fair value.<sup>24</sup> The Arizona Attorney General has opined  
2 that an emergency exists when "sudden change brings hardship to a company, when a  
3 company is insolvent, or when the condition of the company is such that its ability to maintain  
4 service pending a formal rate determination is in serious doubt."<sup>25</sup>

5 The Company has not asserted an emergency nor requested interim rates.  
6 Regardless, and perhaps the reason why the Company has not asserted an emergency, is  
7 because the Company would not meet the legal criteria – there is no evidence of a sudden  
8 change that has brought hardship, no insolvency issue, or evidence that the Company has  
9 an inability to maintain service in the interim or long term for that matter.

#### 11 **5) THE SIB IS NOT IN THE PUBLIC INTEREST**

12 There are numerous reasons why RUCO does not believe the SIB is in the public  
13 interest. The SIB is illegal in Arizona, and hence not in the public interest. The SIB does  
14 not adequately compensate ratepayers for the shift in risk that will result – a five percent  
15 efficiency credit is a paltry quid pro quo. Moreover, at the Company admits, it can wait to  
16 file for the inclusion of the improvements until its next rate case. Transcript at 498-499.

17 For every argument made in support of the SIB, there are counter- points which weigh  
18 more heavily to reject the SIB. There is the argument that the SIB mitigates regulatory lag  
19 alluded to above. This is true; however, this benefit to the Company comes at the higher  
20 expense of regulatory scrutiny. Elimination of regulatory lag is not in the best interests of  
21 ratepayers.

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23 <sup>24</sup> 199 Ariz. at 591, ¶12, citing Scates.

24 <sup>25</sup> 71-17 Opinion Arizona Attorney General at 50. (1971).



1 First, regulatory lag incents the utility to operate as efficiently and as prudently as  
2 possible. Unlike most companies that must compete for customers, a monopoly utility is not  
3 subject to the inherent pressures of a competitive marketplace to manage its costs.  
4 Regulatory lag addresses this problem. By having a "lag" time between when a regulated  
5 utility spends its money and begins recovery of it, regulatory lag exerts pressure on the utility  
6 to act efficiently and prudently.

7 Second, regulatory lag evens out over time. While regulatory lag may place pressure  
8 on the utility in the beginning, that same regulatory lag provides an economic benefit to the  
9 utility in the end. Once plant has been fully depreciated, the utility still earns recovery of  
10 (and recovery on) that plant until the next rate case, which may be several years past when  
11 the plant was fully depreciated.

12 A SIB eliminates regulatory lag on the front end (to the benefit of the utility) at the risk  
13 of reducing pressure to operate prudently and efficiently (to the detriment of the ratepayer).

14 Aside from regulatory lag and the various other arguments, quite simply the SIB is  
15 poor ratemaking as far as the ratepayer is concerned. The SIB is a mechanism that lets a  
16 utility add in-between rate cases gross plant less related depreciation expense to a rate base  
17 determined in a prior rate case. The ratepayer is not protected and a small, token efficiency  
18 credit is not equal to the hope that the end result will imitate or even be close to the rates  
19 the ratepayer would get if all of the rate case elements were scrutinized and applied as would  
20 be required in a rate case.

21 Moreover, given the facts in this case, approval of a SIB would pretty much signal  
22 that any Company that asks for SIB will get it. Here, the Company admits that the previous  
23 recent owner did not keep the repairs and improvements up and that the improvements can  
24 wait until the next rate case. The Company after the acquisition and prior to the present did

1 not put the money in the system that it now claims the system needs. Why is it so critical  
2 and necessary now to do the improvements and not wait until the next rate case to consider  
3 the recovery? The SIB should not be a rubber stamp.

4 **6) INDIVIDUAL CIRCUMSTANCES OF EACH CASE**

5 The individual circumstances in this case are discussed above.

6 **7) THE SIB DOES NOT SET ASIDE DEPRECIATION EXPENSE**

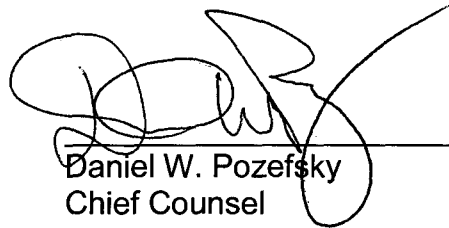
7 Under A.R.S. section 40-222 the Commission can order a public service corporation  
8 to set aside its depreciation expense. If the premise of water and wastewater companies is  
9 their systems/districts are in dire need of repair, and even with a SIB it is not enough, then  
10 why not reinvest monies received through depreciation expense? Instead of these monies  
11 going back to shareholders or other affiliates/companies these monies should be set aside  
12 and be used to pay for improvements and replacement of plant. Based on the circumstances  
13 in this case a SIB mechanism should not be approved.

14 **CONCLUSION**

15 For the above reasons, the Commission should adopt all of RUCO's  
16 recommendations.

1 RESPECTFULLY SUBMITTED this 17<sup>th</sup> day of April, 2015

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Chief Counsel

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